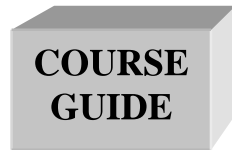
NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCES

COURSE CODE: ENT224

COURSE TITLE: BUSINESS ETHICS



ENT224
BUSINESS ETHICS

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Introduction

ENT224 Business Ethics is a semester course work of two (2) credit units. It is a form of preparation for all students taking the entrepreneurial and related programmes in the School of Business and Human Resources Management.

The course consists of 18 units. It provides an introduction to basic business ethics. Each unit devotes several pages to laying out the empirical information that the decision maker must have if he or she is to apply morality to reality. The goal of every firm is to increase its shareholders' wealth. However, the firm's value diminishes when it does not have the trust of its shareholders.

Without the trust of investors, firms will not be able to obtain new capital and grow. The entire economy suffers when trust is broken. Thus, effective corporate governance can instill confidence and trust in companies and markets. How this can be achieved is fully covered in the course.

Course Contents

The course contents consist of An Introduction to Business Ethics; Ethical Principles in Business; Moral Development and Reasoning; Ethical Theory; Ethics, Justice and Business; The Business Systems; Ethics and Environmentalism; The Ethics of Job Discrimination; Individuals in the Organisation; Corporations and Corporate Governance; Board of Directors; Investment Banking and Security Analysis; Creditors and Credit Procedures; Activities of Shareholders; Corporate Takeovers: Mergers and Acquisitions and Corporate Social Responsibilities.

Course Aim

The main aim of this course is to further expose learners to Business Ethics and Corporate Governance as regards ethical behavior as the best long-term business strategy for a company.

The course is also aimed at making learners appreciate the importance of trust of investors without which firms will not be able to obtain new capital and growth.

Course Objectives

By the end of the course, you should be able to:

- explain the meaning of business ethics
- explain corporate governance
- describe the importance of corporate governance
- apply morality to reality.
- Demonstrate how effective corporate governance can instill confidence and trust in various companies and markets.

Course Materials

The major components of the course are:

1. The Course Guide
2. Study Units
3. Textbooks
4. The Assignment File

Study Units

Module 1

Unit 1 Introduction to Business Ethics
Unit 2 Ethical Principles in Business
Unit 3 Moral Development and Reasoning
Unit 4 Ethical Theories

Module 2

Unit 1 Ethics, Justice and Business
Unit 2 Business System 1
Unit 3 Business System 2
Unit 4 Ethics and Environmentalism

Module 3

Unit 1 Ethics of Job Discrimination
Unit 2 The Individual in the Organisation
Unit 3 Corporations and Corporate Governance 1
Unit 4 Corporations and Corporate Governance 2
Unit 5 Board of Directors

Module 4

Unit 1	Investment Banks and Securities Analysis
Unit 2	Creditors and Credit Procedures
Unit 3	Activities of Shareholders
Unit 4	Corporate Takeovers: Merger and Acquisitions
Unit 5	Corporate Social Responsibilities

Each study unit will take at least two hours to handle. It contains an introduction, objectives, the main content, exercises, conclusion, summary, references and the tutor- marked assignment.

You are expected to study the materials, reflect on them and do the exercises. Some of the exercises will necessitate your visiting some business organisations and web sites.

You are advised to do so in order to appreciate the importance of Ethics and Corporate Governance to the growth of the economy of a nation and the world at large.

There are also lists of textbooks, under references and further reading. They are to give you additional information.

Practise the tutor- marked assignments and the self assessment exercises in each unit for additional and greater understanding of the course.

By doing all these, you will achieve the stated learning objectives.

Assignments

There will be four assignments, one from each module and you are expected to do all the assignments.

Tutor-Marked Assignments (TMAs)

In doing the tutor- marked assignment, you are expected to:

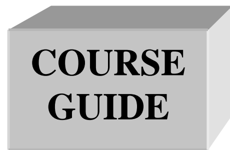
- apply what you have learnt in the study units
- turn in your assignment to your tutor for grading. They are four in number and they constitute 30% of the total score.

Final Examination and Grading

At the end of the course, you will write the final examination. It will attract the remaining 70%; this makes a total final score of 100%.

Summary

Course ENT224 Business Ethics should equip you with an in-depth knowledge and appreciation of the importance of ethics in business and corporate governance in the economy. On the completion of the course, you will find out that without the trust of investors, firms will not be able to obtain new capital and grow and then the entire economy will suffer. Effective corporate governance can instill confidence and as a result, trust in our companies and markets.



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The course is also aimed at making learners appreciate the importance of trust of investors without which firms will not be able to obtain new capital and growth.

Course Objectives

By the end of the course, you should be able to:

- explain the meaning of business ethics
- explain corporate governance
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- apply morality to reality.
- Demonstrate how effective corporate governance can instill confidence and trust in various companies and markets.

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MODULE 1

Unit 1 Introduction to Business Ethics
Unit 2 Ethical Principles in Business
Unit 3 Moral Development and Reasoning
Unit 4 Ethics Theory

UNIT 1 INTRODUCTION TO BUSINESS ETHICS

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  3.2 Meaning of Business Ethics
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  3.3 Morality
  3.4 Ethics and the Law
  3.5 Significance of Business Ethics
  3.6 Influences on Business Ethics
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

This first unit is centered on preliminary topics like, the definition and explanation of key words such as business, ethics and business ethics; the nature of business ethics. The unit finally treated moral reasoning as it relates to business ethics.

In the course of your study, we shall examine the best ways- both moral and ethical- of making profit and contributing to human welfare without doing the contrary.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define and explain Business, Ethics and Business Ethics
- explain moral reasoning
- discuss individual and societal influences on Business Ethics

- identify the significance of this subject matter
- identify the five basic stages of moral development.

3.0 MAIN CONTENT

3.1 Definition of Business and Ethics

Business can simply be defined as the activities of individuals or groups that are involved in developing, producing and distributing the goods and services needed to satisfy other peoples' needs and desires in return for a profit.

The definition we have proposed here is very broad. It shows that businesses can differ widely in size, in the type of products, in nature of ownership and in degree of profitability. The purpose and importance of business is to provide for consumers' needs and to make some money in the process. Hence, the primary purpose of business is to contribute to human welfare and to make profit.

Ethics refer on the other hand, to the principles and standards of moral behaviour that are accepted by society as right versus wrong. To make the right choice, or at least the best choice from among competing alternatives, individuals must think through the consequences of their actions. Ethics can be defined as a set of principles of right conduct. It can also be defined as a theory or a system of moral values. Business ethics is the application of moral standards to business situations.

3.2 Meaning of Business Ethics

Business Ethics has been a growth area in the business world in recent times. Before the advent of business ethics, business transactions have largely been conducted on the principle of *caveat emptor*, meaning *buyer beware.* Much has changed in recent times. The law is the most important source of ensuring that consumers receive a fair deal from retailers and manufacturers. Some of these laws in Nigeria include: the Price Control Act of 1970 as amended by the Price Control Act, 1977; Nigeria Standard Organisation of Nigeria Act of 1971 (SON); National Agency for Food and Drugs Administration and Control Act of 1974(NAFDAC); Weight and Measures Act of 1974, etc. These and other related laws are essentially an imposition of moral consideration on business.

However, this does not imply that business surrenders to the law to resolve its moral dilemmas. This is where business ethics becomes relevant. What then is Business ethics?

Business ethics on the other hand, is defined as a form of the art of applied ethics that examines ethical principles and moral or ethical problems that can arise in a business environment.
Business ethics can also be defined as an act of addressing the morality of economic systems(e.g. the free market, communism, socialism) and the conduct of the organisations found within these systems(e.g. corporation in a free market system).

Many firms have a set of policies on business conduct and legal compliance. The policies embrace ethics, internal controls, conflict of interest and a host of other areas, all of which are designed to promote good and ethical business practices. Employees are acquainted with these policies and are made to sign undertakings to maintain them. As a matter of policy, the company is ready to concede business opportunity in favour of its code of ethics

3.2 Business Ethics and its Issues

In a now-classic study of the Ethics of Business Managers, Raymond Baum had asked more than 100 business people, "What does ethical principles mean to you?" Typical of their replies were the following:

"Before coming to the interview, to make sure that I knew what we would talk about, I looked up ethics in my dictionary. I read it and can't understand it. I don't know what the concept means…"

"Ethics is what my feelings tell me is right. But this is not a fixed standard, and that makes problems. Ethics mean accepted standards in terms of your personal and social welfare; what you believe is right. But what confuses me…is the possibility that I have been misguided, or that somebody else has been poorly educated. Maybe each of us thinks he knows what is ethical, but we differ. How can you tell who is right then.

Of the business people Baum had interviewed, 50 percent defined ethics as "what my feelings tell me is right," 25 percent defined it in religious terms as what is "in accord with my religious beliefs," and 18 percent defined it as what "conforms to the golden rule." Yet feelings are a notoriously inadequate basis on which to make decisions of any sort, and religious authority and the golden rule have been rather devastatingly criticised as inadequate foundations for judging the ethics of business companies. What then do ethics and ethical principles mean?

According to the dictionary, the term ethics has a variety of meanings. One of the meanings given to it is: "the principles of conduct governing an individual or a group." Another definition of ethics is given as "the

study of the general nature of moral choices to be made by a person. Ethics can also be defined as "the rules or standards governing the conduct of a person or the members of a profession e.g. auditing ethics, medical ethics". We sometimes use the term personal ethics, for example, when referring to the rule by which an individual lives his or her personal life. We use the term accounting ethics when referring to the code that guides the professional conduct of accountants (ICAN).

A more important meaning of ethics according to the dictionary is this: Ethics is "the study of morality." Ethicists use the term ethics to refer primarily to the study of morality, just as chemists use the term chemistry to refer to a study of the properties of chemical substances. Although ethics deal with morality, they are not quite the same as morality. Ethics is a kind of investigation and that includes both the activity of investigating as well as the results of that investigation whereas morality is the subject matter that ethics investigate.

3.3 Morality

So then, what, is morality? We can define morality as the standards that an Individual or a group has about what is right and wrong, or good and evil.

Moral standards include the norms we have about the kinds of actions we believe are morally right and wrong as well as the values we place on the kinds of actions we believe are morally good and morally bad. Moral norms can usually be expressed as general rules or statements, such as "Always tell the truth," "It is wrong to kill innocent people," or "Actions are right to the extent that they produce happiness." Moral values can usually be expressed as statements describing objects or features of objects that have worth, such as "Honesty is good" and "injustice is bad."

Where do these standards come from? Typically, a person's moral standards are first imbibed as a child from family, friends and various societal influences such as church, school, television, magazines, music and associations. Later, as the person grows up, experience, learning and intellectual development may lead the maturing person to revise these standards. Some are discarded and new ones may be adopted to replace them. Through this maturing process, the person may develop standards that are more intellectually adequate and so, more suited for dealing with the moral dilemmas of adult life.

What are the characteristics that distinguish moral standards from standards that are not moral? This is not an easy question to answer. However, ethicists have suggested five characteristics that help to pin

down the nature of moral standards. First, moral standards deal with matters that we think can seriously injure or seriously benefit human beings. For example, most people in Nigerian society hold moral standards against theft, rape, enslavement, murder, child abuse, assault, slander, fraud, lawbreaking, and so on. All these plainly deal with matters that people feel are quite serious forms of injury.

Second, moral standards are not established or changed by the decisions of particular authoritative bodies. Laws and legal standards are established by the authority of a legislature or the decisions of voters. Moral standards, however, are not established by any authority, nor does their validity rest on voting procedures. Instead, the validity of moral standards rests on the adequacy of the reasons that are taken to support and justify them; so long as these reasons are adequate, the standards remain valid.

Third, and perhaps most striking, we feel that moral standards should be preferred to other values including (especially) self-interest. That is, if a person has a moral obligation to do something, then he or she is supposed to do it even if this conflicts with other, non-moral values or self-interest.

Fourth, and generally, moral standards are based on impartial considerations. The fact that you will benefit from a lie and that I will be harmed, is irrelevant to whether lying is morally wrong or not. Recent philosophers have expressed this point by saying that moral standards are based on "the moral point of view" that is, a point of view that does not evaluate standards according to whether they advance the interests of a particular individual or group, but one that goes beyond personal interests to a "universal" standpoint in which everyone's interests are impartially counted as equal. Other philosophers have made the same point by saying that moral standards are based on the kinds of impartial reasons, that an "ideal observer" or an "impartial spectator" would accept or that in deciding moral matters "each counts for one and none for more than one." As we shall see in the next unit, however, although impartiality is a characteristic of moral standard, it must be balanced with certain kinds of partiality, in particular, with the partiality that arises from legitimate caring and preference for those individuals with whom we have a special relationship, such as family members and friends. Although morality says that we should be impartial in those contexts where justice is called for, such as assigning salaries in a public company; it also identifies certain contexts, such as taking care of family members, where preferential caring for individuals may be morally legitimate and perhaps even morally required.

Last, moral standards are associated with special emotions and a special vocabulary. For example, if I act contrary to a moral standard, I will normally feel guilty, ashamed, or remorseful; I will characterise my behaviour as "immoral" or "wrong" and I will feel bad about myself and experience loss of self-esteem.

3.4 Ethics and the Law

Many of the most important ethical values form the basis for legislation which governs business activity in general. However, while ethics deal with personal moral principles and values, laws express the standards of a society that can actually be enforced in court. Often, there is fine judgment to be made. If behaviour is not subject to legal penalties and seems reasonably ethical, it is still acceptable.

Using the framework of ethics and the law, a business may be strictly operated on principles which strive to be:

- Ethical and legal: Legal and ethical actions are both acceptable within the legal framework and societal norms. For example, any company with a moral and legal conduct falls into this category. This category involves private firms that are licensed in Nigeria which are equally into legal business e.g. legal chambers, auditing firms.

- Unethical and legal (e.g. selling arms to brutal military dictators).Legal and unethical actions are when law supports what you are doing, but it is unethical because the society frowns at it. E.g. the sale and use of tobacco products (cigarettes and cigars). The former minister of health, Professor Eyitayo Lambo's article stated that about 100 million people die of tobacco-related/induced/sicknesses every year in the world and 1million die every year in Nigeria. If a lot of people die from smoking tobacco yearly, it is then unethical.

- Ethical but illegal: (e.g. publishing stolen but revealing documents about government mismanagement). The law frowns at it, but the society does not. Ethical but illegal patterns of behaviour also include offer of bribes (incentives) in order to secure a contract. In Nigeria, offering of bribe is seen as a way of life.

- Unethical and illegal: Unethical and illegal actions would imply making offerings that have been outlawed and are against societal norms, for example, the drug trade. Employing child labour is also illegal and unethical. The Law does not support it and it is

also unethical because the society frowns at it, e.g. marketing and consumption of cocaine and other hard drugs are banned and seen as unethical in Nigeria and most countries. Abortion is illegal and unethical in Nigeria.

The differences between legal and ethical behaviour is well represented in the model below.

Illegal & unethical	Legal & unethical
Illegal & ethical	Legal & ethical

Fig. 1.1: The Legal and Ethical Dimensions of Marketing the Activity

Laws and regulations are promulgated especially in business to right the wrongs and unwholesome practices by businessmen. Therefore, laws and regulations exist to achieve the following.

- Protect consumers.
- Regulate competition.
- Protect organisations from each other
- Protect the society.

3.5 Significance of Business Ethics

Why should businessmen be ethical in their conduct? Appearing to be ethical, it may be suggested, is simply good business. Other more specific significance of business ethics are as follows.

- Consumers are, arguably, more likely to buy from a company which can be seen to be acting ethically.
- Graduates are more likely to be attracted to companies which treat their employees fairly and give customers a fair deal.
- Ethical business practice is a means of forestalling legislation and stringent government regulations.
- Business ethics requires companies doing their bit to contribute towards a just and fair society, while also ensuring that environmental pollution is brought under control.
- Another significance of business ethics stems from the fact that businesses need to retain the vast amount of social power entrusted to them by the public.

3.6 Influences on Business Ethics

The extent of ethical behaviour of businesses is influenced by the following factors.

- Cultural differences: culture is the way of life of people and transmitted from one generation to another. The extent of ethical behaviour is therefore a function of the culture of a particular country. For instance, what does it mean for a business to do the right thing in China, USA or Nigeria? Taking bribe is considered unethical in USA, whereas *kick-back* is considered a norm in Nigeria and several Third-World nations.

- Knowledge: greater knowledge increases the chance of making the right decision. Business decisions not based on facts or a clear understanding of the consequences could harm employees, customers, the company, and other stakeholders. An employee or manager is held responsible for his/her decisions, actions or inactions. Therefore, the right questions should be asked all the time before decisions are taken.

- Organisational Behaviour: the foundation of an ethical business climate is ethical awareness and clear standards of behaviour. Companies that strongly enforce company codes of conduct and provide ethics training help employees recognise and reason through ethical problems. Similarly, companies with strong ethical practices set a good example for employees to follow. On the other hand, companies that commit unethical acts in the course of doing business open the door for employees to follow suit.

4.0 CONCLUSION

You cannot get too far into the discussion of business ethics without first knowing the definitions of Business, Ethics and by extention Business Ethics.

The unit also examined morality, ethics and the Law as they relate to Business ethics. Finally, significances and influences on Business ethics were mentioned.

5.0 SUMMARY

Ethics is the theory or system of moral values. It is the rules or standards governing the conduct of a person, organisation or company.

Business can mean different things to different people; Businesses is all the objectives that are involved in developing, producing and distributing the goods and services people need to satisfy needs or desires in return for a profit. Hence, business ethics is the study of moral right and wrong as they apply to business organisations, institutions and behaviours. The basic stages of moral development and the nature of moral standards are:

- moral standards deal with matters that we think can seriously injure or seriously benefit human beings
- moral standards are not established or changed by the decisions of particular authoritative bodies.
- moral standards should be preferred to other values including self- interest.
- moral standards should be based on impartial considerations.
- moral standards are associated with special emotions.

Law exists to regulate business activities. Laws are enacted to actually take care of unethical behaviours or behaviours that are below moral/ethical standards. The differences between ethical and legal behaviour are further explained by the following four models which are of ethical and legal.

- illegal and unethical
- legal but unethical
- legal and ethical
- illegal and ethical

6.0 TUTOR–MARKED ASSIGNMENT

1. Explain what your understanding of Business Ethics is.
2. Highlight how the above subject matter influences your attitude towards your business partners and transactions.

7.0 REFERENCES/FURTHER READING

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UNIT 2 ETHICAL PRINCIPLES IN BUSINESS

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1.0 INTRODUCTION

The introductory unit, introduction to Business Ethics has presented a general knowledge of business ethics and the general basis for legislation which governs business activities. This unit treats the topic; Ethical principles in Business extensively.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain in detail, ethics and business
- identify the application of moral standards to business
- describe the moral responsibility of a person in business.

3.0 MAIN CONTENT

3.1 Ethics

Boyd defined ethics as concerned with the development of moral standards by which actions, situations and behaviour can be judged.

Stanton gave the simplest definition of ethics as standards of conduct. Ethics is the discipline that examines one's moral standards or the moral standards of a society. It asks how these standards apply to our lives and whether these standards are reasonable or unreasonable, that is, whether they are supported by good reasons or poor ones. Therefore, a person starts to do ethics when he or she takes the moral standards absorbed from the family, church and friends and asks: "What do these standards imply for the situations in which I find myself? Do these standards really make sense? What are the reasons for or against these standards? Why should I continue to believe in them? What can be said in their favour and what can be said against them? Are they really reasonable for me to hold? Are their implications in this or that particular situation reasonable?"

Ethics is the study of moral standards, the process of examining the moral standards of a person or society to determine whether these standards are reasonable or unreasonable in order to apply them to concrete situations and issues. The ultimate aim of ethics is to develop a body of moral standards that we feel are reasonable to hold standards that we have thought about carefully and have decided are justified standards for us to accept and apply to the choices that fill our lives.

Ethics is not the only way to study morality. The social sciences such as anthropology, sociology and psychology also study morality, but do so in a way that is quite different from the approach to morality that is characteristic of ethics. Although, ethics is a normative study, the social sciences engage in a descriptive study of ethics.

A normative study is an investigation that attempts to reach normative conclusions, that is, conclusions about what things are good or bad or about what actions are right or wrong. In short, a normative study aims to discover what should be. As we have seen, ethics is the study of moral standards whose explicit purpose is to determine as far as possible which standards are correct or supported by the best reasons, and so it attempts to reach conclusions about moral right and wrong and moral good and evil.

A descriptive study is one that does not try to reach any conclusion about what things are truly good, bad or right or wrong. Instead, a descriptive study attempts to describe or explain the world without reaching any conclusions about whether the world is at what it should be. Anthropologists and sociologists, for example, may study the moral standards that a particular village or culture holds. In doing so, they attempt to develop accurate description of the moral standards of that culture and perhaps even to formulate an explanatory theory about their

structure. As anthropologists or sociologists, however, it is not their aim to determine whether these moral standards are correct or incorrect.

3.2 Business Ethics

This characterisation of ethics is intended to convey the idea of what ethics is all about. Our concern here however, is not with ethics in general, but with a particular field of ethics: business ethics. Business ethics is a specialised study of moral right and wrong, as they apply to business institutions, organisations, and behaviours. A brief description of the nature of business institutions should clarify this. A society consists of people who have common ends and whose activities are organised by a system of institutions designed to achieve these ends. That men, women, and children have common ends is obvious. There is the common end of establishing, nurturing, and protecting family life; producing and distributing the materials on which human life depends; restraining and regularising the use of force; organising the means of making collective decisions; and creating and preserving cultural values such as art, knowledge, technology, and religion. Members of a society achieve these ends by establishing the relatively fixed patterns of activity that we call institutions: familial, economic, legal, political, and educational.

The most influential institutions within contemporary societies may be their economic institutions. These are designed to achieve two ends.

1. Production of the goods and services the members of the society want and need.
2. Distribution of these goods and services to the various members of the society. Thus, economic institutions determine who will carry out the work of production, how that work will be organised, what resources that work will consume, and how its products and benefits will be distributed among the society's members.

Business organisations are the primary economic institutions through which people in modern societies carry on the task of producing and distributing goods and services. They provide the fundamental structure within which members of a society combine their scarce resources – land, labour, capital and technology into useable goods, and they provide channels through which these goods are distributed in the form of consumer products, employee salaries, investors' return, and government taxes. Mining, manufacturing, retailing, banking, marketing, transporting, insuring, constructing and advertising are all different facets of the productive and distributive processes of our modern business institutions.

Business Ethics is a study of moral standards and how these apply to the social systems and organisations through which modern societies produce and distribute goods and services and to the behaviours of the people who work within these organisations. Business ethics, in other words, is a form of applied ethics. It not only includes the analysis of moral norms and moral values but also attempts to apply the conclusions of these analyses to that assortment of institutions, organisations, activities and pursuits that we call business.

As this description of business ethics suggests, the issues that business ethics covers encompass a wide variety of topics. To introduce some order into this variety, it helps if we distinguish three different kinds of issues that business ethics investigates: systemic, corporate and individual.

Systemic issues in business ethics are ethical questions raised about the economic, political, legal, and other social systems or institutions within which businesses operate. These include questions about the morality of capitalism or of the laws, regulations, industrial structures and social practices within which businesses operate.

Corporate issues in business ethics are ethical questions raised about a particular organisation. These include questions about the morality of the activities, policies, practices or organisational structure which an individual company takes.

Finally, individual issues in business ethics are ethical questions raised about a particular individual or particular individuals within a company and their behaviours and decisions. These include questions about the morality of the decisions, actions or character of such individuals. It is helpful when analysing the ethical issues raised by a particular decision or case to sort out the issues in terms of whether they are systemic, corporate or individual issues.

Often the world presents us with decisions that involve a large number of extremely complicated and interrelated kinds of issues that can cause confusion unless the different kinds of issues are first carefully sorted out and distinguished from each other. Moreover, the kinds of solutions that are appropriate in dealing with systemic or corporate issues are not the same as the kinds of solutions that are appropriate in dealing with individual issues. If a company is trying to deal with a systemic issue such as a government culture that permits bribery then the issue must be dealt with on a systemic level; that is, it must be dealt with through the coordinated actions of many different social groups. On the other hand, corporate ethical issues can be solved only through corporate or company solutions. If a company has a culture that encourages moral

wrongdoing, for example, then changing that culture requires the cooperation of the many different people that constitute the company. Finally, individual ethical issues need to be resolved through individual decisions and, perhaps, individual reforms.

3.3 Concept of Ethical Conduct

Having known the meaning and importance of business ethics, we can see that wanting to be an ethical corporate citizen is not enough; individuals in business must actively practice *ethical conduct*. In business, besides obeying laws and regulations, a good and ethical conduct involves the followings.

- **Competing fairly and honestly:** businesses are expected to compete fairly and honestly and not knowingly deceive, intimidate, or misrepresent customers, competitors, clients, or employees.

- **Communicating truthfully:** ethical conduct requires that companies refrain from issuing false or misleading communications. Businesses should recognise that their communications reflect their image and therefore refrain from untruthful, offensive and misleading communications.

- **Not causing harm to others:** some business executives put their own personal interests ahead of that of employees and shareholders thereby causing harm to them. Corporate managers can mislead investors by withholding vital information; they sometimes take advantage of the investor by using the company's earnings or resources for personal gain.

3.4 Code of Conduct

A code of conduct is a written statement, setting forth the principles that guide an organisation's decision. An effective code of conduct requires the following.

- Top management commitment
- Employee communications efforts
- Employee commitment to follow it.
- Formal training programmes
- A system that supports reporting unethical or illegal actions at work
- A system of action.

Often, ethical codes do not provide specific guidance on particular issues, and may conflict with the priorities of the commercial world. In such cases, individuals may find themselves torn between the "moral ideals" which they live by, and the legal obligations that is, personal or contractual loyalties which bind them to an employer.

Ethical standards would typically cover matters such as:

- contribution or payment to government officials or political parties
- relations with customers or suppliers
- conflicts of interest
- accuracy of records
- fair and acceptable human resource practices
- competition matters
- corporate social responsibility.

3.5 Applying Ethics to Corporate Organisations

The statement that corporate organisations can be ethical or unethical raises a puzzling issue. Can we really say that the acts of organisations are moral or immoral in the same sense that the actions of human individuals are? Can we say that corporate organisations are morally responsible for their acts in the same sense that human individuals are? Or must we say that it makes no sense to apply moral terms to organisations as a whole but only to the individuals who make up the organisation? Can moral notions like responsibility, wrongdoing and obligation be applied to groups such as corporations, or are individual people the only real moral agents?

Two views have emerged in response to this problem. At one extreme is the view of those who argue that, because the rules that tie organisations together allow us to say that corporations act as individuals and have "intended objectives" for what they do, we can also say that they are "morally responsible" for their actions and that their actions are "moral" or "immoral" in exactly the same sense that a human being's are. The major problem with this view is that organisations do not seem to "act" or "intend" in the same sense that individual human do, and organisations differ from human beings in morally important ways: Organisations feel neither pain nor pleasure and they cannot act except through human beings. At the other extreme is the view of philosophers who hold that it makes no sense to hold business organisations "morally responsible" or to say that they have "moral" duties. These philosophers argue that business organisations are the same as machines whose members must blindly and undeviatingly conform to formal rules that have nothing to do with morality. Consequently, it makes no more

sense to hold organisations “morally responsible” for failing to follow moral standards than it makes to criticise a machine for failing to act morally. The major problem with this second view is that, unlike machines, at least some of the members of organisations usually know what they are doing and are free to choose whether to follow the organisation’s rules or not or even to change these rules. When an organisation’s members collectively, but freely and knowingly, pursue immoral objectives, it ordinarily makes good sense to say that the actions they perform for the organisation are “immoral” and that the organisation is “morally responsible” for this immoral action.

Which of these two extreme views is correct? Perhaps none of the two views is correct. The underlying difficulty with which both views are trying to struggle is this: although we say that corporate organisations “exist” and “act” like individuals, they obviously are not human individuals. Yet our moral categories are designed to deal primarily with individual humans who act on the basis of their own feelings, reasoning, and deliberations. Therefore, how can we apply these moral categories to corporate organisations and their “acts”? We can see our way through these difficulties only if we first see that corporate organisations and their acts depend on human individuals. Organisations are composed of related human individuals that we conventionally agree to treat as a single unit, and they “act” only when we conventionally agree to treat the actions of these individuals, as the actions of that unit. We can express this precisely in two somewhat technical claims that build on the work of philosopher John Searle.

- A corporate organisation “exists” only if:

  - there are certain human individuals who are in certain circumstances and relationships, and
  - our linguistic and social conventions lay down that when those kinds of individuals exist in those kinds of circumstances and relationships, they shall count as a corporate organisation.

- A corporate organisation “acts” only if:

  - certain human individuals in the organisation performed certain actions in certain circumstances and
  - our linguistic and social conventions lay down that when those kinds of individuals perform those kinds of actions in those kinds of circumstances, this shall count as an act of their corporate organisation.

Our own social and legal conventions, for example, say that a corporation exists when there exists a properly qualified group of

individuals who have agreed among themselves to incorporate and they have performed the necessary legal acts of incorporation. Our social conventions also say that a corporation acts when properly qualified members of the corporation, carry out their assigned duties within the scope of their assigned authority.

3.6 Globalisation, Multinational and Business Ethics

Many of the most pressing issues in business ethics today are related to the phenomenon of globalisation. Globalisation is the worldwide process by which the economic and social systems of nations have become connected together so that goods, services, capital, knowledge and cultural artifacts are traded and moved across national borders, at an increasing rate. This process has several components, including the lowering of trade barriers and the rise of worldwide open markets, the creation of global communication and transportation systems; such as the Internet and global shipping, the development of international financial institutions, such as the World Bank and the International Monetary Fund that have facilitated the international flow of capital, and the spread of multinational corporations. For centuries, of course, people have moved and traded goods across national boundaries. Merchants were carrying goods over the trading routes of Europe, Asia, Africa and the Americas almost since civilisation dawned on these places. But the volume of goods that are traded across national boundaries has grown almost exponentially since World War II ended, and it has transformed the face of our world to an extent that was never before possible. Globalisation has resulted in a phenomenon that is familiar to anyone who travels outside their country: The same products, music, foods, clothes, inventions, books, magazines, movie, brand names, stores, cars and companies that we are familiar with at home are available and enjoyed everywhere in the world. Multinational corporations are at the heart of the process of globalisation and are responsible for the enormous volume of international transactions that take place today. A multinational corporation is a company that maintains manufacturing, marketing, service or administrative operations in many different host countries.

3.7 Business Ethics and Cultural Differences

When faced with the fact that different cultures have different moral standards, the managers of some multinationals have adopted the theory of ethical relativism. Ethical relativism is the theory that, because different societies have different ethical beliefs, there is no rational way of determining whether an action is morally right or wrong other than by asking whether the people of this or that society believe it is morally right or wrong. To put it in another way, ethical relativism is the view

that there are no ethical standards that are absolutely true and that apply or should be applied to the companies and people of all societies. Instead, relativism holds that something is right for the people or companies in one particular society, if it accords with their moral standards and wrong for them, if it violates their moral standards.

The multinational company or businessperson who operates in several different countries, then, and who encounters societies with many different moral standards, is advised by the theory of ethical relativism in this way: In one's moral reasoning, one should always follow the moral standards prevalent in whatever society one finds himself. After all, because moral standards differ and since there is no other criterion of right and wrong, the best a company can do is to follow the old adage: "When in Rome, do as the Romans do." However, is this view of ethical relativism a reasonable view to hold?

Considered clearly, there are numerous practices that are immoral by some societies which other societies have deemed morally acceptable, including polygamy, abortion, infanticide, slavery, homosexuality, racial and sexual discrimination, genocide, patricide and the torture of animals. Yet critics of ethical relativism have pointed out that it does not follow that there are no moral standards that are binding on people everywhere. Critics of ethical relativism have argued, in fact, that there are certain moral standards that the members of any society must accept if that society is to survive and if its members are to interact with each other effectively. Thus, all societies have norms against injuring or killing other members of the society, norms about using language truthfully when communicating with members of one's society, and norms against taking the personal goods of other members of one's society.

Moreover, other critics of the theory of ethical relativism point out that, because different people have different moral beliefs on some issues, it does not follow logically that there is no objective truth about that issue or that beliefs about that issue are equally acceptable. When two people or two groups have different beliefs, philosophers are fond of pointing out that, at least one of them is wrong. For example, the late philosopher James Rachels put the matter quite succinctly: The fact that different societies have different moral codes proves nothing. There is also disagreement from society to society about scientific matters: in some cultures it is believed that the earth is flat, and that disease is caused by evil spirits. We do not on that account conclude that there is no truth in geography or in medicine. Instead, we conclude that in some cultures, people are better informed than in others. Similarly, disagreement in ethics might signal nothing more than that some people are less enlightened than others. At the very least, the fact of

disagreement does not, by itself, entail that truth does not exist. Why should we assume that, if ethical truth exists, everyone must know it?

Perhaps the most troubling criticisms ethical relativism must deal with are those that claim that ethical relativism has incoherent consequences. If ethical relativism was true, as the opponents claim, then it would make little sense to criticise the practices of other societies so long as their practices conformed to their own standards.

The fundamental problem with ethical relativism, critics allege, is that it holds that the moral standards of a society are only criteria by which actions in that society can be judged. The theory gives the moral standards of each society a privileged place that is above all criticism by members of that society or by anyone else: A society's moral standards cannot be mistaken. Clearly, opponents say, this implication of ethical relativism indicates that the theory is mistaken. We recognise that the moral standards of our own society as well as those of other societies can be wrong. This recognition implies that the moral standards a society happens to accept cannot be the only criterion of right and wrong.

But even if the theory of ethical relativism is ultimately rejected, this does not mean that it has nothing to teach us. The ethical relativist correctly reminds us that different societies have different moral beliefs and that we should not simply dismiss the moral beliefs of other cultures when they do not match our own. However, ethical relativism may be mistaken in its basic claim that all moral beliefs are equally acceptable and that the only criteria of right and wrong are the moral standards prevalent in a given society.

3.8 Business Ethics and Technology

Technology consists of all those methods, processes, and tools that humans invent to manipulate their environment. To an extent never before realised in history, contemporary business is being continuously and radically transformed by the rapid evolution of new technologies that raise new ethical issues for business.

This is not the first time that new technologies have had a revolutionary impact on business and society. Several thousand years ago, during what is sometimes called the Agricultural Revolution, humans developed the farming technologies that enabled them to stop relying on foraging and on the luck of the hunt and to develop, instead, reasonably constant supplies of food. The invention of irrigation, the harnessing of water and wind power, and the development of levers, wedges, hoists and gears during this period eventually allowed humans to accumulate

more goods than they could consume, and out of this surplus grew trade, commerce and the first businesses.

The result was the large corporations that came to dominate our huge economies and that brought with them, a host of ethical issues for business, including the possibilities of exploiting the workers who laboured at the new machines, manipulating the new financial markets that financed these large enterprises, and producing massive damage to the environment.

New technologies developed in the closing decades of the 20th century and the opening years of the 21st century are again transforming society and business and creating the potential for new ethical problems. Foremost among these developments are the revolutions in biotechnology and in what is sometimes called information technology, including not only the use of extremely powerful and compact computers but also the development of the Internet, wireless communications, digitalisation and numerous other technologies that have enabled us to capture, manipulate and move information in new and creative ways.

Almost all ethical issues raised by new technologies are related in one way or another to questions of risk: Are the risks of a new technology predictable? How large are the risks and are they reversible? Are the benefits worth the potential risks, and who should decide? Do those persons on whom the risks will fall know about the risk, and have they consented to bear these risks? Will they be justly compensated for their losses? Are the risks fairly distributed among the various parts of society, including the poor and the rich, the young and the old, future generations and present ones?

Information technologies have also raised difficult ethical issues about the nature of the right to property when the property in question is information (such as computer software, computer code, or any other kind of data-text, numbers, pictures, sounds-that have been encoded into a computer file) or computer services (access to a computer or a computer system). Computerised information (such as a software programme or digitised pictures) can be copied perfectly countless times without in any way changing the original. What kind of property rights does the original creator of the information have and how does it differ from the property rights of someone who buys a copy? Is it wrong for me to make a copy without the permission of the original creator when doing so in no way changes the original? What, if any, harm will society or individuals suffer if the people are allowed to copy any kind of computerised information at will? Will people stop creating information? For example, will they stop writing software and stop

producing music? What kind of property rights does one have over computer systems? Is it wrong to use my company's computer system for personal business, such as to send personal e-mail or log onto websites that have nothing to do with my work? Is it wrong for me to electronically break into another organisation's computer system if I do not change anything on the system but merely "look around"? Is it ethical for business to market and distribute such unpredictable engineered organisms throughout the world?

3.9 Theories of Business Ethics

3.9.1 Stakeholder Theories

The stakeholder theory of the firm is used as a basis to analyse those groups to whom the firm should be responsible. In this sense, the firm can be described as a series of connections of stakeholders that the managers of the firm attempt to manage. A stakeholder is any group or individual who can affect or is affected by the achievement of the organisation's objectives. Stakeholders are typically analysed into primary and secondary stakeholders. A primary stakeholder group is one without whose continuing participation the corporation cannot survive as a going concern. A primary group includes shareholders and investors, employees, customers and suppliers, together with what is defined as the public stakeholder group: the governments and communities that provide infrastructures and markets, whose laws and regulations must be obeyed, and to whom taxes and obligations may be due. The secondary groups are defined as those who influence or affect, or are influenced or affected by the corporation, but they are not engaged in transactions with the corporation and are not essential for its survival.

3.9.2 Social Contract Theory

The social contract theory has a long tradition in ethical and political theory. In general, this theory considers the society as a series of social contracts between members of society and society itself. The social contact theory in business ethics argues that corporate rights and responsibilities can be inferred from the terms and conditions of an imaginary contract between business and society.

In the context of business ethics, an alternative possibility is not that business might act in a responsible manner because it is in its commercial interest, but because it is part of how society implicitly expects business to operate.

An integrated social contracts theory, as a way for managers to take decisions in an ethical context, has been developed. Here, distinction is made between macro social contracts and micro social contracts. Thus, a macro social contract in the context of communities, for example, would be an expectation that business provides some support to its local community and the specific form of involvement would be the micro social contract. Hence companies who adopt a view of social contracts would describe their involvement as part of "societal expectation".

3.9.3 Legitimacy Theory

Legitimacy is defined as a generalised perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions. There are three types of organisational legitimacy:

- Pragmatic
- Moral
- Cognitive.

It should be pointed out that legitimacy management rests heavily on communication – therefore in any attempt to involve legitimacy theory, there is a need to examine some forms of corporate communications.

Finally, an organisation may employ four broad legitimating strategies when faced with different legitimating threats.

- Seek to educate its stakeholders about the organisation's intentions to improve that performance
- Seek to change the organisation's perceptions of the event (but without changing the organisation's actual performance
- Distract (i.e. manipulate) attention away from the issue of concern
- Seek to change external expectations about its performance.

Thus, there is a need to examine any particular corporate behaviour within its context and in particular to look for alternative motivations. Legitimacy might therefore be seen as a key reason for undertaking corporate social behaviour, and then using that activity as a form of publicity or influence.

SELF ASSESSMENT EXERCISE

Define the following concepts: ethics, business ethics and code of conduct.

4.0 CONCLUSION

Business ethics is a specialised study of moral right and wrong that concentrates on moral standards as they apply to individuals, business institutions, organisations and behaviour.

5.0 SUMMARY

Ethics applies to all human activities. Business cannot survive without ethics.

Ethics is consistent with profit seeking customers and employees must care about ethics.

6.0 TUTOR–MARKED ASSIGNMENT

"Ethics has no place in business" Discuss.

7.0 REFERENCES/FURTHER READING

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UNIT 3 MORAL DEVELOPMENT AND REASONING

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1.0 INTRODUCTION

In the previous unit, we noted that ethics is the study of morality and that a person begins to do ethics when he or she turns to look at the moral standards that have been absorbed from the family, church, friends, and society whether these standards are reasonable or unreasonable and whether these standards imply for situation and issues. In this unit, we shall examine more closely this process of appraising one's moral standards and of applying them to concrete situations and issues. We begin by describing how a person's ability to use and critically evaluate moral standards develops in the course of a person's life, and then we will describe the reasoning processes through which these moral standards are employed and evaluated.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define moral development and moral reasoning
- identify argument for and against business ethics
- examine three objections to bringing ethics into business
- examine the cases for ethics in business
- analyse moral responsibility and blame
- identify subordinates' responsibility.

3.0 MAIN CONTENT

3.1 Moral Development

We sometimes assume that a person's values are formed during childhood and do not change after. In fact, a great deal of psychological research, as well as one's own personal experience, demonstrates that as people mature, they change their values in very deep and profound ways. Just as people's physical, emotional, and cognitive abilities develop as they age, so also their ability to deal with moral issues develops as they move through their lives. In fact, just as there are identifiable stages of growth in the physical development, so the ability to make reasoned moral judgments also develops in identifiable stages.

As children, we are simply told what is right and what is wrong, and we obey so as to avoid punishment: The child's adherence to moral standards is essentially self-absorbed for the avoidance of pain. As we mature into adolescence, these conventional moral standards are gradually internalised. Adherence to moral standards is now based on living up to the expectation of family, friends, and the surrounding society. We do what is right because it is what our groups expect of us.

It is only as rational and experienced adults that we acquire the capacity to critically reflect on the conventional moral standards bequeathed to us by our families, peers, culture, or religion. We then begin to rationally evaluate these moral standards and their consequences and to revise them where they are inadequate, inconsistent or unreasonable. We begin, in short, to do ethics, and our morality now increasingly consists of moral standards that are more impartial and that take into account more of the interests of others, or that more adequately balance taking care of others with taking care of ourselves.

There is a good deal of psychological research that shows people's moral views develop more or less in this manner. The psychologist Lawrence Kohlberg, for example, who pioneered research in this field, concluded on the basis of over 20 years of research that there is a sequence of six identifiable stages in the development of a person's ability to deal with moral issues.

Kohlberg's theory is useful because it helps us understand how our moral capacities develop and reveals how we can become increasingly sophisticated and critical in our use and understanding of the moral standards we hold. Research by Kohlberg and others has shown that, although people generally progress through the stages in the same sequence, not everyone progresses through all the stages. Kohlberg found that many people remain stuck at one of the early stages

throughout their lives. For those who remain at the pre-conventional level, right and wrong always continue to be defined in the egocentric terms of avoiding punishment and doing what powerful authority figures say; for those who reach the conventional level but never get any further, right and wrong continue to defined in terms of conventional norms of their social groups or the laws of their nation or society. However, for those who reach the post conventional level and take a reflective and critical look at the moral standards they have been raised to hold, moral right ad wrong are decided in terms of moral principles they have chosen for themselves as more reasonable and adequate.

It is important to notice that Kohlberg implies that the moral reasoning of people at the later stages of moral development, are better than the reasoning of those at earlier stages. First, people at the later stages have the ability to see things from a wider and fuller perspective than those at earlier stages. The person at the pre-conventional level can see situations only from the person's own egocentric point of view; the person at the conventional level can see situations only from the familiar viewpoints of people in the person's own social groups; and the person at the post-conventional point of view has the ability to look at situations from a perspective that tries to take into account everyone affected by the decision.

Second, people at the later stages have better ways of justifying their decisions to others than those at earlier stages. The person at the pre-conventional level can justify decisions only in terms of how the person's own interests will be affected, and therefore, justifications are ultimately persuasive only to the person. The person at the conventional level can justify decisions in terms of the norms of the group to which the person belongs, and therefore justifications are ultimately persuasive only to members of the person's group. Finally, the person at the post conventional level can justify what the person does on the basis of moral principles that are impartial and reasonable and that can therefore appeal to any reasonable person.

Kohlberg's theory has, however, been subjected to a number of criticisms. First, Kohlberg has been criticised for claiming that the higher stages are morally preferable to the lower stages. This criticism is surely right. Although the higher Kohlberg levels incorporate broader perspectives and widely acceptable justifications, it does not follow that these perspectives are morally better than the lower ones. To establish that the higher stages are morally better will require more argument than Kohlberg provides. In later units, we shall see what kind of reasons can be given for the view that the perspectives and justifications of the moral principles characteristic of the later Kohlberg stages, are morally preferable to those of the earlier stages.

3.2 Moral Reasoning

We have used the term moral reasoning repeatedly. What does it mean? Moral reasoning refers to the reasoning process by which human behaviours, institutions, or policies are judged to be in accordance with or in violation of moral standards. Moral reasoning always involves two essential components:

An understanding of what reasonable moral standards require prohibits value or condemn:

Evidence or information that shows that a particular person, policy, institution, or behaviour has the kinds of features that these moral standards require, prohibit value or condemn.

In many cases, one or more of the three components involved in a person's moral reasoning are not expressed. More often than not, people will fail to make explicit, the moral standards on which their moral judgments are based. The main reason that moral standards are often not made explicit is that they are generally presumed to be obvious. People put more of their efforts into producing evidence that a given policy, institution, or action conforms to, or violates their unexpressed standards than they put into identifying or explaining the moral standards on which their judgments rely.

Failure to make one's moral standards explicit leaves one vulnerable to all the problems, created by basing critical decisions on unexamined assumptions: The assumptions may be inconsistent, they may have no rational basis, and they may lead the decision maker into unwittingly making decisions with undesirable consequences. We saw at the end of the last section two arguments that tried to show that managers should not be ethical but both of which were based on assumed moral standards that were unacceptable once they were made explicit.

To uncover the implicit moral standards on which a person's moral judgments are founded, one has to retrace the person's moral reasoning back to its bases. This involves asking:

What factual information does the person accept as evidence for this moral judgment?

What moral standards are needed to relate this factual information (logically) to the moral judgment? For example, suppose I judge that capital punishment is morally wrong. Further, suppose I base my judgment on the factual evidence that capital punishment occasionally results in the death of innocent people. Then, in order to relate this factual information to my judgment, I must accept this general moral

principle: Whatever occasionally results in the death of innocent people is morally wrong. This general moral principle is needed if there is to be a (logical) connection between the factual information ("capital punishment occasionally results in the death of innocent people") and the moral judgment that is based on this fact ("capital punishment is morally wrong"). Without the moral principle, the factual information would have no logical relation to the judgment and would therefore be irrelevant.

The moral standards on which adults base their moral judgments are usually much more complex than this simple example suggests. Developed moral standards (as we see) incorporate qualifications, exceptions and restrictions that limit their scope. Also, they may be combined in various ways with other important standards. However, the general method of uncovering unexpressed moral standards remains roughly the same whatever their complexity. One may ask: What general standards relate a person's factual evidence to his or her moral judgments?

It is hoped that this account of ethical reasoning, has not suggested that it is always easy to separate factual information from moral standards in a piece of moral reasoning; nothing could be farther from the truth. In practice, the two are sometimes intertwined in ways that are difficult to disentangle. There are several theoretical difficulties in trying to draw a precise line separating the two. Although the difference between the two is usually clear enough for practical purposes, the reader should be aware that sometimes they cannot be clearly distinguished.

3.3 Arguments for and against Business Ethics

We have described business ethics as the process of rationally evaluating our moral standards and applying them to business situations. However, many people have raised objections to the very idea of applying moral standards to business activities. In this section, we will address some of these objections and also look at what can be said in favour of bringing ethics into business.

3.3.1 Three Objections to Bringing Ethics into Business

Occasionally people object to the view that ethical standards should be applied to the behaviour of people in business organisations. Persons involved in business, they claim, should single-mindedly pursue the financial interests of their firm and not sidetrack their energies or their firm's resources into "doing good works". Three different kinds of arguments are advanced in support of this view.

First, some have argued that in perfectly competitive free markets, the pursuit of profit will by itself ensure that the members of society are served in the most socially beneficial ways. To be profitable, each firm has to produce only what the members of society want and has to do this by the most efficient means available. The members of society will benefit most, then, if managers do not impose their own values on a business, but instead devote themselves to the single-minded pursuit of profit and thereby to producing efficiently what the members of society value.

Arguments of this sort conceal a number of assumptions that require a much, lengthier discussion than we can provide at this stage. Because we examine many of these claims in greater detail in the units that follow, here we only note some of the more questionable assumptions on which the argument rests. First, most industrial markets are not "perfectly competitive" as the argument assumes, and to the extent that firms do not have to compete they can maximise profits despite inefficient production. Second, the argument assumes that any steps taken to increase profits will necessarily be socially beneficial, when in fact several ways of increasing profits actually injure society: allowing harmful pollution to go uncontrolled, deceptive advertising, concealing product hazards, fraud, bribery, tax evasion, price fixing, and so on. Third, the argument assumes that, by producing whatever the buying public wants (or values), firms are producing what all the members of society want, when in fact the wants of large segments of a society (the poor and disadvantaged) are not necessarily met because they cannot participate fully in the marketplace. Fourth, the argument is essentially making a normative judgment (“managers should devote themselves to the single-minded pursuit of profits”) on the basis of some assumed but unproved moral standards (“people should do whatever will benefit those who participate in markets”). Thus, although the argument tries to show that ethics does not matter, it can do this only by assuming an unproved moral standard that at least appears mistaken.

A second kind of argument sometimes advanced to show that business managers should single-mindedly pursue the interests of their firms and should ignore ethical considerations is embodied in what Alex C. Michaels called the "loyal agent's argument." The argument can be paraphrased as follows:

As a loyal agent of his or her employer, the manager has a duty to serve the employer as the employer would want to be served (if the employer had the agent's expertise).

An employer would want to be served in whatever ways will advance his or her self-interests. Therefore, as a loyal agent of the employer, the manager has a duty to serve the employer in whatever ways will advance the employer's self interests.

The argument can be, and often has been, used to justify a manager's unethical or illegal conduct. For example, the officer of a corporation may plead that, although he engaged in certain illegal or unethical conduct (e.g., price fixing), he should be excused because he did it not for himself, but to protect the best interests of his company, its shareholders, or its workers. The loyal agent's argument underlies this kind of excuse. More generally, if we replace *employer* with *government* and *manager* with *officer,* we get the kind of argument that Nazi officers used after World War II to defend their involvement in Hitler's morally corrupt government.

The loyal agent’s argument relies on several questionable assumptions. First, the argument tries to show, again, that ethics does not matter by assuming an unproved moral standard (“the manager *should* serve the employer in whatever way the employer wants to be served”). But there is no reason to assume that this moral standard is acceptable as it stands and some reason to think that it would be acceptable only if it were suitably qualified (e.g., “the manager should serve the employer in whatever *moral* way the employer wants to be served”). Second, the loyal agent's argument assumes that there are no limits to the manager's duties to serve the employer, when in fact such limits are an express part of the legal and social institutions from which these duties arise. An agent's duties are defined by what is called the law of agency (i.e., the law that specifies the duties of persons [agents] who agree to act on behalf of another party and who are authorised by the agreement so to act). Lawyers, managers, engineers, stockbrokers, and so on all act as agents for their employers in this sense. By freely entering an agreement to act as someone’s agent, then, a person accepts a legal (and moral) duty to serve the client loyally, obediently, and in a confidential manner as specified in the law of agency.

Yet, the law of agency states that “in determining whether or not the orders of the [client] to the agent are reasonable, business or professional ethics are to be considered,” and “in no event would it be implied that an agent has a duty to perform acts which are illegal or unethical.” The manager’s duties to serve the employer, then, are limited by the constraints of morality, because it is with this understanding that the duties as a loyal agent are defined. Third, the loyal agent's argument assumes that if a manager agrees to serve a firm, then this agreement automatically justifies whatever the manager does on behalf of the firm. However, this assumption is false: Agreements to serve other people do not automatically justify doing wrong on their behalf. For example, it is clearly wrong for me to kill an innocent person to advance my own interests.

Suppose that one day I enter an agreement to serve your interests and that later it turns out that your interests require that I kill an innocent person for you. Does the agreement now justify my killing the innocent person? Obviously, it does not because agreements do not change the moral character of wrongful acts. If it is morally wrong, then, for a manager to do something out of self-interest, it is also morally wrong for the manager to do it in the interests of the company even though the manager has agreed to serve the company. The assumptions of the loyal agent's argument, then, are mistaken.

A third kind of objection is sometimes made against bringing ethics into business. This is the objection that to be ethical it is enough for business people merely to obey the law: Business Ethics is essentially obeying the law. For example, when an accountant was asked to prepare a business ethics report for the board of directors of Seven - Eleven Stores, his report excluded allegations that a store manager was trying to bribe New York tax officials. When asked why the alleged bribery attempt was excluded from the report, he replied that he did not feel the incident was unethical because it was not illegal, implying that *unethical* and *illegal* are the same. .

It is wrong, however, to see laws and ethics as identical. It is true that some laws require behavior that is the same as the behaviour required by our moral standards. Examples of these are laws that prohibit murder, rape, theft, fraud, and so on. In such cases, law and morality coincide, and the obligation *to* obey such laws is the same as the obligation to be moral. However, law and morality do not always coincide. Some laws have nothing to do with morality because they do not involve serious matters. These include parking laws, dress codes, and other laws covering similar matters.

Other laws may even violate our moral standards so that they are actually contrary to morality. Pre-Civil War slavery laws, for example, required slave owners to treat slaves like property, and the laws of Nazi Germany required anti-Semitic behavior. The laws of Saudi Arabia today require that businesses discriminate against women and Jews in ways that most people would say are clearly immoral. Thus, it is clear that ethics is not simply following the law.

This does not mean, of course, that ethics has nothing to do with following the law. Our moral standards are sometimes incorporated into the law, when enough of us feel that a moral standard should be enforced by the pressures of a legal system. In contrast, laws are sometimes criticised and eliminated when it becomes clear that they blatantly violate our moral standards.

Moreover, most ethicists agree that all citizens have a moral obligation to obey the law, so long as the law does not require clearly unjust behaviour. This means that, in most cases, it is immoral to break the law. Tragically, the obligation to obey the law can create terrible conflicts, when the law requires something that the businessperson believes is immoral. In such cases, a person will be faced with a conflict between the obligation to obey the law and the obligation to obey his or her conscience

3.3.2 The Case for Ethics in Business

We have looked at several arguments attempting to establish that ethics should not be brought into business and we found them all wanting. Is there anything to be said for the opposite claim that ethics should be brought into business? One way to argue that ethics should be brought into business is simply by pointing out that, ethics should govern all voluntary human activities. And because business is a voluntary human activity, ethics should also govern business. In short, there is nothing about business that would prevent us from applying the same standards of ethics to business activities that should be applied to all voluntary human activities.

Another argument for the view that ethics should be part of business points out that business activities, like any other human activities, cannot exist unless the people involved in the business and its surrounding community, adhere to some minimal standards of ethics. Business is a cooperative activity whose very existence requires ethical behaviour. First, any individual business will collapse if all of its managers, employees, and customers come to think that it is morally permissible to steal from the organisation, lie to, or break their agreement with the company.

Because no business can exist entirely without ethics, the pursuit of business requires at least a minimal adherence to ethics on the part of those involved in it. Second, all businesses require a stable society in which to carry on business dealings. Yet the stability of any society requires that its members adhere to some minimal standards of ethics. In a society without ethics, as the philosopher Hobbes once wrote, distrust and unrestrained self-interest would create “a war of every man against every man,” and in such a situation life would become “nasty, brutish, and short.”

The impossibility of conducting business in such a society – one in which lying, theft, cheating, distrust, and unrestrained self-interested conflict are the norm – is shown by the rate at which business activities break down in societies torn by strife, conflict, distrust, and civil war. Because businesses cannot survive without ethics, then, it is in the best

interests of business to promote ethical behaviour both among its own members as well as within its larger society.

Another persuasive way to argue that ethics should be brought into business is by showing that ethical considerations are consistent with business pursuits, in particular with the pursuit of profit. That ethics is consistent with the pursuit of profit can be shown by simply finding examples of companies where the history of good ethics has existed side by side with the history of profitable operations.

3.4 Moral Responsibility and Blame

So far, our discussion has focused on judgements of right and wrong and of good and evil. Moral reasoning, however, is sometimes directed at a different kind of judgment: determining whether a person is morally responsible for an injury or for a wrong. A judgment about a person's moral responsibility for wrongdoing is a judgment that the person acted intentionally and so should be blamed, punished, or forced to pay restitution.

The kind of moral responsibility we are discussing here, should not be confused with a second but distinct form of moral responsibility. The term moral responsibility is sometimes used to mean "moral duty" or "moral obligation." moral responsibility" means "moral obligation." This is not the kind of moral responsibility that we are talking about here. We are concerned here with the kind of moral responsibility a person has when we say a person is to blame for something. "Morally responsible" is used to mean "to blame."

People are not always morally responsible for the injuries they inflict on others. A person, for example, who injures someone by accident, is "excused" from any blame. So when is a person morally responsible-or to blame-for an injury? The traditional view can be summarised like this: A person is morally responsible for an injury when the person caused the injury and did so knowingly and freely. But this characterisation ignores the fact that people are sometimes responsible for injuries which they did not cause but which they could and should have prevented, that is, they are morally responsible for their omissions when they had a duty to act. So, a more accurate-but more complicated-way of characterising moral responsibility is as follows:

A person is morally responsible for an injury or a wrong if:

- the person caused or helped cause it, or failed to prevent it when he could and should have; and
- the person did so knowing what he or she was doing
- the person did so of his own free will.

Moral responsibility for an injury or a wrong, then, requires three things:

- the person must cause or fail to prevent the injury or wrong when he could and should have done so.
- the person must know what he is doing.
- the person must act of his own free will. This means the absence of any of these three elements will completely eliminate a person's responsibility for an injury and so will fully "excuse" a person from any blame for the injury.

It is important to understand these three conditions well enough to judge whether a party was morally responsible for something.

Let us begin by examining the first requirement for moral responsibility: The person must either cause the injury or wrong or else must fail to prevent it when she could and should have done so. In many cases, it is easy to determine whether a person's actions "caused" an injury or a wrong (such actions are "commissions"). But this is not so easy when a party does not cause an injury but merely fails to prevent it (such failures are "omissions"). Nike, the athletic shoe company, for example, has been at the center of a controversy over its responsibility for the mistreatment of the workers who make its shoes. Nike does not actually manufacture any of the athletic shoes it sells. Instead, Nike designs its shoes in Seattle, Washington, and then pays companies in developing countries to make the shoes according to these designs. It is these foreign supplier companies (in China, Indonesia, India, etc.) that have directly mistreated and exploited their workers. Nike has claimed that it is not morally responsible for this mistreatment because the injuries were inflicted by the supplier companies they hired, so Nike itself did not cause the injuries.

Critics have responded that although it is true that Nike did not directly cause the injuries, Nike could have prevented those injuries by forcing its suppliers to treat their workers humanely. If it is true that Nike had the power to prevent the injuries, and should have done so, then Nike met the first condition for moral responsibility. But if Nike was truly powerless to prevent these injuries if Nike had no control over the actions of its suppliers then it did not meet' the first condition.

Notice that the first condition says that people are morally responsible for an injury when they failed to prevent it, *only if* they "should have" prevented it. This qualification is necessary because people cannot be held morally responsible for all the injuries they know about and fail to prevent. Each of us is not morally responsible, for example, for failing to save all the members of all the starving groups in the world that we learn about by reading the newspapers, even if we could have saved

some of them. If we were morally responsible for all these deaths, then we would all be murderers many times over and this seems wrong.

Instead, we must say that a person is responsible for failing to prevent an injury only when, for some reason, the person had an obligation to prevent that particular injury. Such an obligation generally requires some sort of special relationship to the injury or the injured party. For example, if it is known I am the only person near enough to save a drowning child, and I can do so easily, then my special physical relationship to the child creates in me an obligation to save the child and so I am morally responsible for the child's death if I fail to prevent it. Or if I am a police officer on duty and see a crime that I can easily prevent, because it is my job to prevent such crimes, I have a specific obligation to prevent this crime and am morally responsible if I fail to do so. Employers likewise have a special obligation to prevent work injuries from being inflicted on their employees and so are morally responsible for any foreseen work injuries they could have prevented.

The second requirement for moral responsibility is this: The person must know what he/she is doing. This means that if persons are ignorant of the fact that their actions will injure someone else, then they cannot be morally responsible for that injury. Ignorance, however, does not always excuse a person. One exception is when a person deliberately claims ignorant of a certain matter to escape responsibility. For example, if Nike managers told their suppliers that they did not want to know what was going on in their factories, they would still be morally responsible for whatever mistreatment went on that they could have prevented. A second exception is when a person negligently fails to take adequate steps to become informed about a matter that is of known importance.

A manager in an asbestos company, for example, who has reason to suspect that asbestos may be dangerous but who fails to become informed on the matter out of laziness, cannot later plead ignorance as an excuse. A person may be ignorant of either the relevant facts or the relevant moral standards. For example, I may be sure that bribery is wrong (a moral standard) but may not have realised that in tipping a customs official, l was actually bribing him into cancelling certain import fees (a fact). In contrast, I may be genuinely ignorant that bribing government officials is wrong (a moral standard), although I know that in tipping the customs official, I am bribing him into reducing the fees I owe (a fact). If I genuinely did not know that what I was doing was wrong, then I am not morally responsible for that wrong.

Ignorance of fact eliminates moral responsibility, for the simple reason that a person cannot be held responsible for something over which he or she has no control. Because people cannot control matters of which they are ignorant, their moral responsibility for such matters is eliminated. Negligently or deliberately created ignorance, is an exception to this principle because such ignorance can be controlled. Insofar as we can control the extent of our ignorance, we become morally responsible for it and, therefore, also for its injurious consequences. Ignorance of the relevant moral standards generally also removes responsibility because a person is not responsible for failing to meet obligations of whose existence he or she is genuinely ignorant. However, to the extent that our ignorance of moral standards is the result of freely choosing not to ascertain what these standards are, we are responsible for our ignorance and for its wrongful or injurious consequences.

The third requirement for moral responsibility is that the person must act of his own free will. A person act of his/her own free will when that person acts deliberately or purposefully and his actions are not the result of some uncontrollable mental impulse or external force. In other words, a person act of his own free will when he chooses to do something for a reason or a purpose and is not forced to do it by some internal or external force over which he has no control. A person is not morally responsible, for example, if he causes an injury because he lacked the power, skill, opportunity, or resources to prevent his actions from resulting in the injury. Nor is a person morally responsible when he is not physically forced to inflict an injury on someone else or physically restrained from doing something to prevent the injury, nor when a person's mind is psychologically impaired in a way that prevents him/her from controlling his/her actions.

3.4.1 Corporate Responsibility

Within the modern corporation, responsibility for a corporate act is often distributed among a number of cooperating parties. Corporate acts are normally brought about by several actions or omissions of many different people all cooperating together so that their linked actions and omissions jointly produce the corporate act. For example, one team of managers designs a car, another team tests it, and a third team builds it; one person orders, advises, or encourages something and others act on these orders, advice, or encouragement; one group knowingly defrauds buyers and another group knowingly but silently enjoys the resulting profits; one person contributes the means and another person accomplishes the act; one group does the wrong and another group conceals it. The variations on cooperation are endless.

The question is, “who is morally responsible for such jointly produced acts”? The traditional view is that those who knowingly and freely did

what was necessary to produce the corporate act, are each morally responsible. In this view, situations in which a person needs the actions of others to bring about a wrongful corporate act are no different in principle from situations in which a person needs certain external circumstances to commit a wrong. For example, if I want to shoot an innocent person, I must rely on my gun going off (an external circumstance). If I want to defraud the stockholders of a corporation, I must rely on others to do their part in the fraud. In both cases, I can bring about the wrongful injury only by relying on something or someone other than myself. In both cases, if I knowingly and freely bring about the fraud, then I am morally responsible for the wrongful injury.

Bringing about a wrongful act with the help of others, then, does not differ in a morally significant way from deliberately bringing about a wrongful act with the help of inanimate instruments: The person is fully responsible for the wrong or the injury even if this responsibility is shared with others. If, for example, as a member of the board of directors of a corporation, with full knowledge and complete freedom, I act on insider information to vote for some stock options that will benefit me but unfairly injure the other stockholders, then I am morally responsible for the wrongful corporate act of the board even if, I share this responsibility with other members of the board. By my vote, I was trying to bring about the illegal corporate act and I did so knowingly and freely.

Critics of this traditional view of the individual's responsibility for corporate acts have claimed that when an organised group such as a corporation acts together, their corporate act may be described as the act of the group and, consequently, the corporate group and not the individuals who make up the group must be held responsible for the act. For example, we normally credit the manufacturer of a defective car to the corporation that made it and not to the individual engineers involved in its manufacture.

The law typically attributes the acts of a corporation's managers to the corporation (so long as the managers act within their authority) and not to the managers as individuals. Traditionalists, however, can reply that, although we sometimes attribute acts to corporate groups, this linguistic and legal fact does not change the moral reality behind all such corporate acts: Individuals had to carry out the particular actions that brought about the corporate act. Because individuals are morally responsible for the known and intended consequences of their free actions, any individual who knowingly and freely joins his actions together with those of others, intending thereby to bring about a certain corporate act, will be morally responsible for that act.

3.4.2 Subordinates' Responsibility

In a corporation, employees often act on the basis of their superiors' orders. Corporations usually have a hierarchical structure of authority in which orders and directives pass from those higher in the structure, to a variety of agents at lower levels. A vice president tells several middle managers that they must reach certain production goals and the middle managers, try to attain them. A plant manager tells the foremen to close down a certain line and the foremen do it. An engineer tells a clerk to write up a certain report and the clerk does it. Who is morally responsible when a superior orders a subordinate to carry out an act that both of them know is wrong?

People sometimes suggest that when a subordinate acts on the orders of a legitimate superior, the subordinate is absolved of all responsibility for that act: Only the superior is morally responsible for the wrongful act, even though the subordinate was the agent who carried it out. Several years ago, for example, the managers of a national semiconductor plant allegedly ordered their employees to write a government report that falsely stated that certain computer components sold to the government had been tested for defects. Some employees objected, but when the managers allegedly insisted, the employees complied with their orders. When the falsified reports were discovered, the managers argued that only the corporation as a whole should be held responsible for the falsified reports. No individual employee should be held morally responsible, they argued, because each employee was simply an agent who was following orders.

It is clearly mistaken, however, to think that an employee who freely and knowingly does something wrong is absolved of all responsibility when "following orders." Moral responsibility requires merely that one acts freely and knowingly, and it is irrelevant that one's wrongful act is that of freely and knowingly choosing to follow an order. For example, if I am ordered by my superior to murder a competitor and I do so, I can hardly later claim that I am totally innocent because I was merely "following orders." The fact that my superior ordered me to perform what I knew was an immoral act in no way alters the fact that in performing that act, I knew what I was doing and I freely chose to do it and so I am morally responsible for it. As we noted when discussing the "loyal agent" argument," there are limits to an employee's obligation to obey a superior: An employee has no obligation to obey an order to do what is immoral. Of course, a superior can put significant economic pressures on an employee and such pressures can mitigate the employee's responsibility, but they do not totally eliminate it.

Thus, when a superior orders an employee to carry out an act that both of them know is wrong, the employee is morally responsible for that act if the employee carries it out. Is the superior also morally responsible? Obviously, the superior is also morally responsible because in ordering the employee, the superior is knowingly and freely bringing about the wrongful act through the instrumentality of the employee. The fact that a superior uses a human being to bring about the wrongful act does not change the fact that the superior brought it about.

3.5 Reasons for Ethical Behaviour

Why do organisations need to be ethical?

- **To reverse declining public confidence**: As far as many people are concerned, organisational/business image and reputation are sometimes highly questionable. This is as a result of negative business practices, such as poor product quality, misleading package labels, and false advert claims, etc. To reverse this trend, businesses must demonstrate convincingly that they are aware of their ethical responsibility by setting and enforcing high ethical standards.

- **To avoid increase in government regulation**: This is applicable where businesses operate in relatively free economic systems, devoid of government regulations. To justify this, businesses must act ethically in such a way that their customers and other stakeholders have no reasons to complain about their activities and attract government attention. Note that in a free economic system, everybody is given the liberty to operate.

- **To retain the power granted by the society**: Businesses wield enormous social power as they influence markets, economic issues and consumers' behaviour. Unethical behaviour will result in an erosion of this. To avoid this, businesses should act in a socially acceptable manner.

- **To protect the company's image**: Public relation is an element of promotional tool. Big organisations use public relations. If an Organisation is ethical, likely to spend less on public relations. For example, former BATA now FAMAD does not sell its products to middlemen, discovering that most distributors are profit conscious and care less about the image of the company. Another good example of people/consumers viewing your product in a good way with a good image is seen in the Indomie noodles crisis and that of All-ways sanitary towels, which were rumoured to have been contaminated, and unfit for consumption.

The above mentioned examples were handled by the public relations unit of the affected companies to help retain their customers and to equally create a good image for their companies.

SELF ASSESSMENT EXERCISE

Define the following concepts; autonomous morality, moral reasoning, pre conventional morality, conventional morality, consistency requirement, ethic relativism and moral responsibility.

4.0 CONCLUSION

Morality should govern all voluntary activities and as business is a voluntary human activity, morality should also govern business. There is nothing about business that would prevent us from applying the same moral standards to its activities as should be applied to all other human activity.

5.0 SUMMARY

Having described morality in business as the process of rationally evaluating our moral standards and applying them to business situations, many people have raised objections to the very idea of applying moral standards to business activities where an employee is regarded as and remains a "loyal agent" of his or her employer. Thus, employees are constantly faced with a conflict between the obligation to obey the law and the obligation to obey their conscience (moral standards).

6.0 TUTOR–MARKED ASSIGNMENT

1. Explain Kohlberg's views of moral development.
2. Highlight the reasons why organisations need to be ethical.

7.0 REFERENCES/FURTHER READING

Manuel G. Velasquez: *Business Ethics Concepts and Cases*.

Kenneth A. Kim & John R. Nofsinger: *Corporate Governance.*

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UNIT 4 ETHICS THEORY

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1.0 INTRODUCTION

Ethics theory refers to the various kinds of approaches to moral evaluation that constitute some of the most important types of ethical standards studied by moral philosophers. Each approach to moral evaluation employs distinct moral concepts, and each emphasises aspects of moral behaviour that are neglected or at least not emphasised by the others. The purpose of this unit is to explain the kinds of concepts and information that each employs, identify their strengths and weaknesses, and explain how these approaches can be used to clarify the moral issues that confront people in business

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain how to apply the theory of ethics
- identify and discuss how the concepts of a "right" should be applied to business situations.

3.0 MAIN CONTENT

3.1 Views of Ethical Behaviours

We can distinguish between four views of ethical behaviours. They are:

- **Utilitarian view:** It is based on the notion that ethics should deliver the greatest number of people.
- **Individualism view:** This view seeks to advance the long term self interest of individuals.
- **Moral right view:** This emphasises respect for and protection of the fundamental right of people.
- **Justices view:** Ethical behaviour or decision should treat people impartially and fairly according to guiding rules and standards.

The attention of this course unit shall be on utilitarianism, that is, the utilitarian view.

3.2 Utilitarianism: Weighing Social Costs and Benefits

We begin by looking at that approach to moral decision making, that the Caltex managers took when they claimed that they should remain in South Africa because, that course of action would have the most beneficial consequences. This approach is sometimes referred to as a consequentiality approach and sometimes as a utilitarian approach. To see more clearly what the approach involves, let us look at a situation where this approach was a basic consideration in a business decision that had a dramatic impact on the lives of many people.

During the last century, Ford lost its market share to Japanese companies making compact, fuel-efficient cars. Lee Iacocca, president of Ford at the time, determined to regain Ford's share by rapidly developing a new small car called the Pinto. The Pinto would weigh less than 2,000 pounds, cost less than $2,000, and be brought to market in 2 years instead of the normal 4. Because the Pinto was a rush project, styling considerations dictated engineering design to a greater degree than usual. In particular, the Pinto's styling required that the gas tank be placed behind the rear axle, where it was more vulnerable to being punctured in case of a rear-end collision. When an early model of the Pinto was crash-tested, it was found that, when struck from the rear at 20 miles per hour or more, the gas tank would sometimes rupture and gas would spray out and into the passenger compartment. In a real accident, stray sparks might explosively ignite the spraying gasoline and possibly burn any trapped occupants.

Ford managers decided, nonetheless, to go ahead with production of the Pinto for several reasons. First, the design met all the applicable legal and government standards then in effect. At the time, government regulations required that a gas tank only remain intact in a rear-end collision of less than 20 miles per hour. Second, Ford managers felt that the car was comparable in safety to several other cars then, being produced by other auto companies. Third, according to an internal cost-benefit study that Ford carried out, the costs of modifying the Pinto would not be balanced by the benefits. The study showed that modifying the gas tank of the ₦1875 million autos that would eventually be built would cost about ₦1610 a unit for ₦20, 550 million. **Costs**: ₦1610 X ₦1875 million autos ₦20, 550 million

However, statistical data showed that the modification would prevent the loss of about 180 burn deaths, 180 serious burn injuries, and 2,100 burned vehicles. At the time (1970), the government officially valued a human life at ₦3, 000000, insurance companies valued a serious burn injury at ₦10, 050000, and the average residual value on subcompacts was ₦10, 5000. So in monetary terms, the modification would have the benefit of preventing losses with a total value of only ₦737, 25 million:

Benefits: (180 deaths X ₦3,000000) + (180 injuries X ₦10,050000) + (2,100 vehicles X ₦10,5000) ₦737,25 million

Thus, a modification that would ultimately cost customers ₦20, 550 million (because the costs of the modification would be added to the price of the car) would result in the prevention of customer losses valued at only ₦737, 25 million. It was not right, the study argued, to spend ₦20, 550 million of society's money to provide a benefit society valued at only ₦737, 25 million. . .

Ford subsequently went ahead with the production of the unmodified Pinto. It is estimated that in the decade that followed at least 60 persons died in fiery accidents, involving Pintos and that at least twice that number suffered severe burns over large areas of their bodies, many requiring years of painful skin grafts. Ford eventually phased out the Pinto model.

The kind of analysis that Ford managers used in their cost-benefit study, is a version of what has been traditionally called *utilitarianism.* Utilitarianism is a general term for any view that holds that actions and policies should be evaluated on the basis of the benefits and costs they will impose on society. In any situation, the "right" action or policy is the one that will produce the greatest net benefits or the lowest net costs (when all alternatives have only net costs).

The Ford managers reduced costs and benefits primarily to economic costs and benefits (such as medical costs, loss of income, and damage to buildings) and these were measured in monetary terms. But the benefits of an action, may include any desirable goods (pleasures, health, lives, satisfactions, knowledge, happiness) produced by the action, and costs may include any of its undesirable evils (pain, which the Ford study did take into account, sickness, death, dissatisfaction, ignorance, unhappiness). The inclusive term used to refer to the net benefits of any sort produced by an action is utility. Hence, the name *utilitarianism* is used for any theory that advocates selection of that action or policy that maximises benefits (or minimises costs).

Many business analysts hold that the best way to evaluate the ethical propriety of a business decision or any other decision is by relying on utilitarian cost-benefit analysis. The socially responsible course for a business to take is the one that will produce the greatest net benefits for society or impose the lowest net costs. Several government agencies, many legal theorists, numerous moralists, and a variety of business analysts advocate utilitarianism. We begin our discussion of ethical principles by examining this popular approach.

3.2.1 Traditional Utilitarianism

Jeremy Bentham (1748-1832) is generally considered the founder of traditional utilitarianism. J Bentham sought an objective basis for making value judgments that would provide a common and publicly acceptable norm for determining social policy and social legislation. The most promising way to reach such an objective ground of agreement, he believed, is by looking at the various policies a legislature could enact and comparing the beneficial and harmful consequences of each. The right course of action from an ethical point of view would be to choose the policy that would produce the greatest amount of utility. Summarised, the utilitarian principle holds that an action is right from an ethical point of view, if and only if the sum total of utilities produced by that act is greater than the sum total of utilities produced by any other act the agent could have performed in its place.

The utilitarian principle assumes that we can somehow measure and add the quantities of benefits' produced by an action and subtract from them the measured quantities of harm the action will have and thereby determine which action produces the greatest total benefits or the lowest total costs. That is, the principle assumes that all the benefits and costs of an action can be measured on a common numerical scale and then, added or subtracted from each other. The satisfactions that an improved work environment imparts to workers, for example, might be equivalent to 500 positive units of utility, whereas the resulting bills that arrive the

next month might be equivalent to 700 negative units of utility. Therefore, the total combined utility of this act (improving the work environment) would be 200 units of *negative* utility.

When the utilitarian principle says that the right action for a particular occasion is the one that produces more utility than any other possible action, it does not mean that the right action is the one that produces the most utility for the person performing the action. Rather, an action is right if it produces the most utility for *all* persons affected by the action (including the person performing the action). Nor does the utilitarian principle say that an action is right so long as its benefits outweigh its costs. Rather, utilitarianism holds that, in the final analysis, only one action is right: that one action whose net benefits are the greatest by comparison to the net benefits of all other possible alternatives. A third misunderstanding, is to think that the utilitarian principle requires us to consider only the direct and immediate consequences of our actions: Instead, both the immediate and all foreseeable future costs and benefits that each alternative will provide for each individual, must be taken into account as well as any significant indirect effects.

Consequently, to determine how I should behave on a particular occasion, I must do three things. First, I must determine what alternative actions or policies are available to me on that occasion. The Ford managers, for example, were implicitly considering two alternatives: to redesign the Pinto by putting a rubber bladder around the gas tank or leave it as originally designed. Second, for each alternative action, I must estimate the direct and indirect benefits and costs that the action will probably produce, for each and every person affected by the action in the foreseeable future. Ford's calculations of the costs and benefits that all affected parties would have to bear if the Pinto design were changed, and those that all parties would have to bear if it were not changed, are examples of such estimates. Third, the alternative that produces the greatest sum total of utility must be chosen as the ethically appropriate course of action. The Ford managers, for example, decided that the course of action that would impose the lowest costs and the greatest benefits would be, to leave the Pinto design unchanged

Utilitarianism is in many respects an attractive theory. For one thing, it matches fairly nicely the views that we tend to advocate when discussing the choice of government policies and public goods. Most people agree, for example, that when the government is trying to determine on which public projects it should spend tax monies, the proper course of action would be for it to adopt those projects that objective studies show will provide the greatest benefits for the members of society at the least cost. Of course, this is just another way of saying that the proper government policies are those that would have

the greatest measurable utility for people-or, in the words of a famous slogan, those that will produce "the greatest good for the greatest number."

Utilitarianism also seems to fit in rather neatly with the intuitive criteria that people employ when discussing moral conduct. For example, when people explain why they have a moral obligation to perform some action, they often proceed by pointing to the benefits or harms the action will impose on human beings. Utilitarianism also has the advantage of being able to explain why we hold that certain types of activities are generally morally wrong (lying, adultery, killing) while others are generally morally right (telling the truth, fidelity, keeping one's promises).

The utilitarian can say that lying is generally wrong because of the costly effects of lying on our human welfare. When people lie to each other, they are less apt to trust each other and cooperate with each other. The less trust and cooperation, the more our welfare declines. Telling the truth is generally right because, it strengthens cooperation and trust and thereby improves everyone's well-being. In general, then, it is a good rule of thumb to tell the truth and to refrain from lying. Traditional utilitarian would deny, however, that any kinds of actions are always right or always wrong. They would deny, for example, that dishonesty or theft is necessarily always wrong.

Utilitarian views have also been highly influential in economics. A long line of economists, beginning from the 19th century, argued that economic behaviour could be explained by assuming that human beings always attempt to maximise their utility and that the utilities of commodities can be measured by the prices people are willing to pay for them. With these and a few other simplifying assumptions (such as the use of indifference curves), economists were able to derive the familiar supply and demand curves of sellers and buyers in markets and explain why prices in a perfectly competitive market gravitate toward an equilibrium. More important, economists were also able to demonstrate that a system of perfectly competitive markets, would lead to a use of resources and price variations that would enable consumers, to maximise their utility (defined in terms of Pareto optimality) through their purchases. On utilitarian grounds, therefore, these economists concluded that such a system of markets is better than any other alternative.

Utilitarianism is also the basis of the techniques of economic **cost-benefit** analysis. This type of analysis is used to determine the desirability of investing in a project (such as a dam, factory, or public park) by figuring whether its present and future economic benefits,

outweigh its present and future economic costs. To calculate these costs and benefits, discounted monetary prices are estimated for all the effects the project will have on the present and future environment and on present and future populations. Carrying out these sorts of calculations is not always an easy matter, but various methods have been devised for determining the monetary prices of even such intangible benefits, as the beauty of a forest (e.g., we might ask how much people pay to see the beauty of a similar privately owned park). In this form of utilitarianism, the concept of utility is restricted to monetarily measurable economic costs and benefits.

Finally, we can note that utilitarianism fits nicely with a value that many people prize: efficiency, Efficiency can mean different things to different people, but for many it means operating in such a way that one produces the most one can with the resources at hand. That is, an efficient operation is one that produces a desired output with the lowest resource input. Such efficiency is precisely what utilitarianism advocates because, it holds that one should always adopt the course of action that will produce the greatest benefits at the lowest cost.

3.2.2 Measurement Problems

One major set of problems with utilitarianism is centered on the difficulties encountered when trying to measure utility. One problem is this: How can the utilities different actions have for different people be measured and compared as utilitarianism requires? Suppose you and I would both enjoy getting a certain job: How can we figure out whether the utility you would get out of having the job, is more or less than the utility I would get out of not having it? Each of us may be sure that he or she would benefit most from the job, but because we cannot get into each other's skin, this judgment has no objective basis. Comparative measures of the values things have for different people cannot be made, the critics argue, thus there is no way of knowing whether utility would be maximised by giving me the job or giving you the job. If we cannot know which actions will produce the greatest amounts of utility, then we cannot apply the utilitarian principle.

A second problem is that some benefits and costs seem intractable to measurement. How, for example, can one measure the value of health or life? Suppose that installing an expensive exhaust system in a workshop, will eliminate a large portion of certain carcinogenic particles that workers might otherwise inhale. Suppose that as a result some of the workers probably will live 5 years longer. How one to calculate the value of those years of added life, and how is this value to be quantitatively balanced against the costs of installing the exhaust system? The Ford managers, when considering the deaths that the Pinto

design would cause, decided that a human life was worth $200,000 (in 1970 dollars). But doesn't the price they assigned to a life seem arbitrary and doesn't the attempt to price life seem morally inappropriate?

A third problem is that, because many of the benefits and costs of an action cannot be reliably predicted, they also cannot be adequately measured. The beneficial or costly consequences of basic scientific knowledge, for example, are notoriously difficult to predict. Yet, suppose that one has to decide how much to invest in a research programme that will probably uncover some highly theoretical, but not immediately usable, information about the universe. How is the future value of that information to be measured, and how can it be weighed against either the present costs of funding the research or the more certain benefits that would result from putting the funds to an alternative use, such as adding a new wing to the local hospital or building housing for the poor?

Yet a fourth problem is that it is unclear exactly what is to count as a benefit and what is to count as a cost. This lack of clarity is especially problematic with respect to social issues that are given significantly different evaluations by different cultural groups. Suppose a bank must decide, for example, whether to extend a loan to the manager of a local pornographic theater or to the manager of a bar that caters to homosexuals. One group of people may see the increased enjoyment of pornography connoisseurs or the increased enjoyment of homosexuals as benefits accruing to society. Another group, however, may see these as harmful and hence as costs.

3.2.3 Utilitarian Replies to Measurement Objections

The defender of utilitarianism has an array of replies ready to counter the measurement objections enumerated.

First, the utilitarian may argue that, although utilitarianism ideally requires accurate quantifiable measurements of all costs and benefits, this requirement can be relaxed when such measurements are impossible. Utilitarianism merely insists that the consequences of any projected act, be expressly stated with as much clarity and accuracy as is humanly possible and that all relevant information concerning these consequences, be presented in a form that will allow them to be systematically compared and impartially weighed against each other. Expressing this information in quantitative terms facilitates such comparisons and weighing. However, where quantitative data are unavailable, one may legitimately rely on shared and commonsense judgments of the comparative values things have for most people. For example, we know that, by and large, cancer is a greater injury than a

cold no matter who has the cancer and who has the cold. Similarly, a plate of pounded-yam has a greater value as food than a groundnut no matter whose hunger is involved.

The utilitarian can also point to several commonsense criteria that can be used to determine the relative values that should be given to various categories of goods. One criterion, for example, depends on the distinction between intrinsic and instrumental goods. Instrumental goods are things that are considered valuable only because they lead to other good things. A painful visit to the dentist, for example, is only an instrumental good (unless I happen to be a masochist): It is desired only as a means to health.

Intrinsic goods, however, are things that are desirable independent of any other benefits they may produce. Thus, health is an intrinsic good: It is desired for its own sake. (Many things, of course, have both intrinsic and instrumental value. I may use a skateboard, for example, not only because skateboarding is a means to health and rapid transportation but also because I enjoy skateboarding for it). Now it is clear that intrinsic goods take priority over instrumental goods. Under most circumstances, for example, money, which is an instrumental good, must not take priority over life and health, which have intrinsic value.

A second common-sense criterion that can be used to weigh good turns is the distinction between needs and wants. To say that someone needs something is to say that without it that person will be harmed in some way. People's "basic" needs consist of their needs for things without which they will suffer some fundamental harm such as injury, illness, or death. Among a person's basic needs are the food, clothing, and housing required to stay alive; the medical care and hygienic environment required remaining healthy; and the security and safety required to remain free from injury. However, to say that a person wants something is to say that the person desires it: The person believes it will advance his or her interests in some way. A need, of course, may also be a want: If I know I need something, then I may also want it. Many wants, however, are not needs but simply desires for things without which the individual would not suffer any fundamental harm. I may want something simply because I enjoy it, even though it is a luxury I could as well do without. Desires of this sort that are not also needs are called *mere* wants. In general, satisfying a person's basic needs is more valuable than satisfying his or her mere wants. If people do not get something for which they have a basic need, they may be injured in a way that makes it impossible for them to enjoy the satisfaction of any number of mere wants. Because the satisfaction of a person's basic needs makes possible not only the intrinsic values of life and health, but also

the enjoyment of most other intrinsic values, satisfaction of the basic needs has a value that is greater than that of satisfying mere wants.

However, these commonsense methods of weighing goods are only intended to aid us in situations where quantitative methods fail. In actual fact, the consequences of many decisions are relatively amenable to quantification, the convinced utilitarian will claim. This constitutes the utilitarian's second major reply to the measurement objections as previously outlined.

The most flexible method of providing a common quantitative measure for the benefits and costs associated with a decision, the utilitarian may hold, is in terms of their monetary equivalents. Basically, this implies that the value a thing has for a person can be measured by the price the person is willing to pay for it. In short, market prices can serve to provide a common quantitative measure of the various benefits and costs associated with a decision. In general, to determine the value of a thing, one needs merely ask what it sells for on an open market. If the item does not sell on an open market, then one can ask what the selling price for a similar item is.

The use of monetary values also has the advantage of allowing one to take into account the effects of the passage, of time and the impact of uncertainty. If the known monetary costs or benefits lie in the future, then their present values can be determined by discounting them at the appropriate rate of interest. If the monetary costs or benefits are only probable and not certain, then their expected values can be computed by multiplying the monetary costs or benefits by the appropriate probability factor.

A standard objection against using monetary values to measure all costs and benefits is that some goods, in particular health and life, cannot be priced. The utilitarian may argue, however, that not only is it possible to put a price on health and life but that we do so almost daily. Anytime people place a limit on the amount of money they are willing to pay to reduce the risk that some event poses to their lives, they have set an implicit price on their own lives. For example, suppose that people are willing to pay NS for a piece of safety equipment that will reduce the probability of their being killed in an auto accident from *.00005* to .00004, but they are unwilling to pay any more than that. Then, in effect, they have implicitly decided that .00001 of a life is worth NS or, in other words that a life is worth *N500, 000.* Such pricing is inevitable and necessary, the utilitarian may hold, so long as we live in an environment in which risks to health and life can be lowered only by giving up (trading off) other things that we may want and on which we set a clear price.

Finally, the utilitarian may say, where market prices are incapable of providing quantitative data for comparing the costs and benefits of various decisions, other sorts of quantitative measures are available. Should people disagree, for example, as they often do, over the harmful or beneficial aspects of various sexual activities, then sociological surveys or political votes can be used to measure the intensity and extensiveness of people’s attitudes. Economic experts can also provide informed judgments of the relative quantitative values of various costs and benefits. Thus, the utilitarian will grant that the problems of measurement encountered by utilitarianism are real enough.

3.2.4 Problems with Rights and Justice

The major difficulty with utilitarianism, according to some critics, is that it is unable to deal with two kinds of moral issues: that relating to rights and those relating to justice. That is, the utilitarian principle implies that certain actions are morally right when in fact they are unjust or violate people’s rights. Some examples may serve to indicate the sort of difficult counter examples critics pose for utilitarianism.

First, suppose that your uncle has an incurable and painful disease, so that he is quite unhappy but does not choose to die. Although he is hospitalised and will die within a year, he continues to run his chemical plant. Because of his own misery, he deliberately makes life miserable for his workers and has insisted on not installing safety devices in his chemical plant, although he knows that as a result one life will certainly be lost over the next year. You, his only living relative, know that on your uncle's death you will inherit his business and not only will you be wealthy and immensely happy but you also intend, to prevent any future loss of life by installing the needed safety devices. You are cold-blooded and correctly judge, that you could secretly murder your uncle without being caught and without your happiness being in any way affected by it afterward. If it is possible for you to murder your uncle without in any way diminishing anyone else's happiness, then according to utilitarianism you have a moral obligation to do so. By murdering your uncle, you are trading his life for the life of the worker, and you are gaining your happiness while doing away with his unhappiness and pain-the gain is obviously on the side of utility. However, the critics of utilitarianism claim, it seems quite clear that the murder of your uncle would be a gross violation of his right to life. Utilitarianism has led us to approve an act of murder that is an obvious violation of an individual's most important right.

Second, utilitarianism can also go wrong, according to the critics, when it is applied to situations that involve social justice. For example, suppose that subsistence wages force a small group of migrant workers, to continue doing the most undesirable agricultural jobs, in an economy

but produce immense amounts of satisfaction for the vast majority of society's members, because they enjoy cheap vegetables and savings that allow them to indulge other wants. Suppose also that the amount of satisfaction thereby produced, when balanced against the unhappiness and pain imposed on the small group of farm workers, results in a greater net utility than would exist if everyone had to share the burden of farm work. Then, according to the utilitarian criterion, it would be morally right to continue this system of subsistence wages for farm workers.

However, to the critics of utilitarianism, a social system that imposes such unequal sharing of burden is clearly immoral and offends against justice. The great benefits the system may have for the majority does not justify the extreme burden that it imposes on a small group. The shortcoming this counter example reveals is that utilitarianism allows benefits and burdens to be distributed among the members of society in any way whatsoever, so long as the total amount of benefit is maximised. In fact, some ways of distributing benefits and burdens (like the extremely unequal distributions involved in the counter example) are unjust regardless of how great the store of benefits such distributions produce. Utilitarianism looks only at how much utility is produced in a society and fails to take into account, how that utility is distributed among the members of society.

3.2.5 Utilitarian Replies to Objections on Rights and Justice

To deal with the sorts of counter examples that critics of traditional utilitarianism have offered, utilitarian have proposed an important and influential alternative version of utilitarianism called rule-utilitarianism. The basic strategy of the rule-utilitarian is to limit utilitarian analysis to the evaluations of moral rules. According to the rule utilitarian, when trying to determine whether a particular action is ethical, one is never supposed to ask whether that particular action will produce the greatest amount of utility. Instead, one is supposed to ask whether the action is required by the correct moral rules that everyone should follow. If the action is required by such rules, then one should carry out the action. But what are the "correct" moral rules? It is only this second question, according to the rule-utilitarian, that is supposed to be answered by reference to maximising utility. The correct moral rules are those that would produce the greatest amount of utility, if everyone were to follow them. An example may make this clear.

Suppose I am trying to decide whether it is ethical for me to fix prices with a competitor. Then, according to the rule-utilitarian, I should not ask whether this particular instance of price-fixing will produce more utility than anything else I can do. Instead, I should first ask myself:

What are the correct moral rules with respect to price-fixing? Perhaps I might conclude, after some thought, that the following list of rules includes all the candidates.

- Managers are never to meet with competitors for the purpose of fixing prices
- Managers may always meet with competitors for the purpose of fixing prices.
- Managers may meet with competitors for the purpose of fixing prices when they are losing money.

Which of these three is the correct moral rule? According to the rule-utilitarian, the correct moral rule is the one that would produce the greatest amount of utility for everyone affected. Let us suppose that after analysing the economic effects of price fixing, I conclude that within our economic and social circumstances people would benefit much more if everyone followed Rule 1 than if everyone followed Rule 2 or 3. If this is so, then Rule 1 is the correct moral rule concerning price-fixing. Now that I know what the correct moral rule on price-fixing is, I can go on to ask a second question: Should I engage in this particular act of fixing prices? To answer this second question, I only have to ask: What is required by the correct moral rules? As we have already noted, the correct rule is to never fix prices. Consequently, even if on this particular occasion, fixing prices actually would produce more utility than not doing so, I am, nonetheless, ethically obligated to refrain from fixing prices because this is required by the rules from which everyone in my society would most benefit.

The theory of the rule-utilitarian then has two parts, which we can summarise in the following two principles:

- An action is right from an ethical point of view if and only if the action would be required by those moral rules that are correct.
- A moral rule is correct if and only if the sum total of utilities produced, if everyone were to follow that rule is greater than the sum total of utilities produced by everyone were to follow some alternative rule.

Thus, according to the rule-utilitarian, the fact that a certain action would maximise utility on one particular occasion does not show that it is right from an ethical point of view.

For the rule-utilitarian, the flaw in the counter examples that the critics of traditional utilitarianism offer is that in each case the utilitarian criterion is applied to particular actions and not to rules. Instead, the rule-utilitarian would urge that we must use the utilitarian criterion to

find out what the correct moral rule is for each counterexample and then evaluate the particular actions involved in the counter example only in terms of this rule. Doing this allows utilitarianism to escape the counter examples undamaged.

3.3 Rights and Duties

The concept of a right plays a crucial role in many of the moral arguments and moral claims invoked in business discussions. Employees, for example, argue that they have a "right to equal pay for equal work"; managers assert that unions violate their "right to manage"; investors complain that taxation violates their "property rights"; and consumers claim that they have a "right to know." Moreover, public documents often employ the notion of a right. United Nations adopted a "Universal Declaration of Human Rights," which claimed that "all human beings" are entitled, among other things,

- the right to own property alone as well as in association with others.
- the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment
- the right to just and favorable remuneration ensuring for (the worker) and his family an existence worthy of human dignity.
- the right to form and to join trade unions.
- the right to rest and leisure, including reasonable limitation of working hours and periodic holidays with pay.

The concept of a right and the correlative notion of duty, then, lie at the heart of much of our moral discourse. This section is intended to provide an understanding of these concepts and of some of the major kinds of ethical principles and methods of analysis that underlie their use.

3.3.1 The Concept of a Right

In general, a right is an individual's entitlement to something. A person has a right when that person is entitled to act in a certain way or is entitled to have others act in a certain way toward him or her. The entitlement may derive from a legal system that permits or empowers, the person to act in a specified way or that requires others to act in certain ways toward that person; the entitlement is then called a legal right. Legal rights are limited, of course, to the particular jurisdiction within which the legal system is in force.

Entitlements can also derive from a system of moral standards independently of any particular legal system. The rights to work for example, many argue, is a right that all human beings possess. Such rights, which are called moral rights or human rights, are based on moral norms and principles that specify that all human beings are permitted or empowered, to do something or are entitled to have something done for them. **Moral rights,** unlike legal rights, are usually thought of as being universal insofar as they are rights that all human beings of every nationality possess to an equal extent simply by virtue of being human beings. Unlike legal rights, moral rights are not limited to a particular jurisdiction.

The most important moral rights-and those that will concern us in this unit are rights that impose prohibitions or requirements on others and that thereby enable individuals to choose freely whether to pursue certain interests or activities. These moral rights (we mean these kinds of rights when we use the term moral rights), identify those activities or interests that the individual is empowered to pursue, or must be left free to pursue, or must be helped to pursue, as the individual chooses; and they protect the individual’s pursuit of those interests and activities within the boundaries specified by the rights. These kinds of moral rights have three important features that define these enabling and protective functions.

First, moral rights are tightly correlated with duties. This is because one person's moral right generally can be defined-at least partially-in terms of the moral duties other people have towards that person. To have a moral right necessarily implies that others have certain duties toward the bearer of that right. My moral right to worship as I choose, for example, can be defined in terms of the moral duties other people have to not interfere in my chosen form of worship. The moral right to a suitable standard of living can be defined in terms of the duty that governments (or some other agents of society); have to ensure a suitable standard of living for their citizens. Duties, then, are generally the other side of moral rights: If I have a moral right to do some thing, then other people have a moral duty not to interfere with me when I do it; if I have a moral right to have someone do something for me, then that other person (or group of persons) has a moral duty to do it for me. Thus, moral rights impose correlative duties on others-either duties of non interference or duties of positive performance.

Second, moral rights provide individuals with autonomy and equality in the free pursuit of their interests. That is, a right identifies activities or interests that people must be left free to pursue or not pursue as they choose (or must be helped to pursue as they freely choose) and whose pursuit must not be subordinated to the interests of others except for

special and exceptionally weighty reasons. If I have a right to worship as I choose, for example, then this implies that I am free to worship if and as I personally choose and that I am not dependent on anyone's permission to worship. It also implies that I cannot generally be forced to stop worshipping on the grounds that society will gain more benefits, if I am kept from worshipping: The gains of others do not generally justify interference with a person's pursuit of an interest or an activity, when that pursuit is protected by a moral right. To acknowledge a person's moral right, then, is to acknowledge that there is an area in which the person is not subject to my wishes and in which the person's interests are not subordinate to mine. There is an area, in short, within which we stand as autonomous equals.

Third, moral rights provide a basis for justifying one's actions and for invoking the protection or aid of others. If I have a moral right to do something, then I have a moral justification for doing it. Moreover, if I have a right to do something, then others have no justification for interfering with me. On the contrary, others are justified in restraining any persons who try to prevent me from exercising my right, or others may have a duty to aid me in exercising my right. When a stronger person helps a weaker one defend his or her rights, for example, we generally acknowledge that the act of the stronger person was justified.

Because moral rights have these three features, they provide bases for making moral judgments that differ substantially from utilitarian standards. First, moral rights express the requirements of morality from the point of view of the *individual,* whereas utilitarianism expresses the requirements of morality from the point of view of *society as a whole.* Second, rights limit the validity of appeal to social benefits and to numbers. That is, if a person has a right to do something, then it is wrong for anyone to interfere, although a large number of people might gain much more utility from such interference. If I have a right to life, for example, then it is morally wrong for someone to kill me even if many others would gain much more from my death than I will ever gain from living.

Although, rights generally override utilitarian standards, they are not immune from all utilitarian considerations: If the utilitarian benefits or losses imposed on society become great enough, they might be sufficient to breach the protective walls the right sets up around a person's freedom to pursue individual interests. In times of war or major public emergencies, for example, it is generally acknowledged that civil rights may legitimately be restricted for the sake of the public welfare.

3.3.2 Negative and Positive Rights

A large group of rights called negative rights is distinguished by the fact that its members can be defined wholly in terms of the duties others have not to interfere in certain activities of the person who holds a given right . For example, if I have a right to privacy, this means that every other person, including my employer, has the duty not to intervene in my private affairs.

In contrast, positive rights do more than impose negative duties. They also imply that some other agents have the positive duty of providing the holders of the right with whatever they need to freely pursue their interests. For example, if I have a right to an adequate standard of living, this does not merely mean that others must not interfere; it also means that if I am unable to provide myself with an adequate income, then I must be provided with such an income (perhaps by the government). Similarly, the right to work, the right to an education, the right to adequate health care, and the right to social security are all rights that go beyond non interference to also impose a positive duty of providing people with something when they are unable to provide it for themselves.

Positive rights were not emphasised until the 20th century. Negative rights were often employed in the 17th and 18th centuries by writers of manifestos, who were anxious to protect individuals against the encroachments of monarchical governments. Positive rights became important in the 20th century when society increasingly took it on itself to provide its members with the necessities of life that they were unable to provide for themselves. The United Nations declaration, for example, is influenced by this trend when it provides for the rights "to food, clothing, housing, and medical care." The change in the meaning of the phrase "the right to life" is another indication of the rising importance of positive rights. Whereas the 18th century interpreted the "right to life" as the negative right not to be killed, the 20th century has reinterpreted the phrase to refer to the positive right to be provided with the minimum necessities of life.

3.3.3 Contractual Rights and Duties

Contractual rights and duties (sometimes called *special rights and duties* or *special obligations)* are the limited rights and correlative duties that arise when one person enters an agreement with another person. For example, if 1 am contracted to do something for you, then you are entitled to my performance: You acquire a contractual *right* to whatever I promised; and I have a contractual *duty* to perform as I promised.

Contractual rights and duties are distinguished, first, by the fact that they attach to *specific* individuals and the correlative duties are imposed only on other *specific* individuals. Second, contractual rights arise out of a specific transaction between particular individuals. Unless I actually make a promise or enter some other, similar arrangement with you, you do not acquire any contractual rights over me.

Third, contractual rights and duties depend on a publicly accepted system of rules that define the transactions that give rise to those rights and duties. Without the institution of contract and the rights and duties it can create, modern business societies could not operate. Virtually every business transaction at some point requires one of the parties to rely on the word of the other party to the effect that the other party will pay later, will deliver certain services later, or will transfer goods of a certain quality and quantity. The institution of contracts provides a way of ensuring that individuals keep their word, and this in turn makes it possible for business society to operate.

We should recall here that a person's institutional duties are not unlimited. In the first unit we noted that, as a "loyal agent," the manager's duties to care for the corporation are limited by the ethical principles that govern any person. Similarly, a doctor cannot murder other people to obtain vital organs for the patients for whom he or she has a duty to care.

What kind of ethical rules govern contracts? The system of rules that underlies contractual rights and duties has been traditionally interpreted as including several moral constraints thus:

- both of the parties to a contract must have full knowledge of the nature of the agreement they are entering.
- neither party to a contract must intentionally misrepresent the facts of the contractual situation to the other party.
- neither party to the contract must be forced to enter the contract under duress or coercion.
- the contract must not bind the parties to an immoral act.

Contracts that violate one or more of these four conditions have traditionally been considered void. The basis of these sorts of conditions is discussed next.

3.3.4 A Basis for Moral Rights: Kant

How do we know that people have rights? This question can be answered in a fairly straightforward way when it is asked about legal rights: A person has certain legal rights because the person lives within a

legal system that guarantees those rights. However, what is the basis of moral rights?

Utilitarian have suggested that utilitarian principles can provide a satisfactory basis for moral rights: People have moral rights because the possession of moral rights maximises utility. It is doubtful, however, that utilitarianism can serve as an adequate basis for moral rights. To say that someone has a moral right to do something is to say that person is entitled to do it regardless of the utilitarian benefits it provides for others. Utilitarianism cannot easily support such a non utilitarian concept.

A more satisfactory foundation for moral rights is provided by the ethical theory developed by Immanuel Kant (1724-1804). Kant in fact, attempts to show that there are certain moral rights and duties that all human beings possess regardless of any utilitarian benefits that the exercise of those rights and duties may provide for others.

Kant's theory is based on a moral principle that he called the categorical imperative and that requires that everyone should be treated as a free person equal to everyone else. That is, everyone has a moral right to such treatment, and everyone has the correlative duty to treat others in this way. Kant provides at least two ways of formulating this basic moral principle; each formulation serves as an explanation of the meaning of this basic moral right and correlative duty.

3.3.5 Kantian Rights

A large number of authors have held that the categorical imperative (in one or the other of its formulations) explains why people have moral rights. As we have seen, moral rights identify interests that individuals must be left free to pursue as they autonomously choose (or which we must help them pursue as they choose) and whose free pursuit must not be subordinated to our own interests. That is precisely what both formulations of Kant's categorical imperative require, in holding that people must be respected as free and equal in the pursuit of their interests.

In short, moral rights identify the specific major areas in which persons must deal with each other as free equals, and Kant's categorical imperative implies that persons should deal with each other in precisely this way. The categorical imperative, however, cannot by itself tell us what particular moral rights human beings have. To know what particular rights human beings have, one first must know what interests humans have and whether there are good reasons for giving the free pursuit of one interest, rather than another, the protected status of a right (clearly, not all interests can be turned into rights, because interests can

conflict with each other). For example, to establish that humans have a right to free speech, one has to show that freedom to say what one chooses, is critically important to human beings and that it is more important than the free pursuit of other conflicting interests that humans may have (such as an interest in repressing ideas that we find distasteful, offensive, or disturbing). Insofar as free speech is critically important, humans must leave each other equally free to speak as they choose: Everyone has a moral right to freedom of speech. However, insofar as free speech conflicts with another human interest that can be shown to be of equal or greater importance (such as our interest in not being libeled or defamed), the right to freedom of speech must be limited.

3.3.6 The Problems with Kant

Despite the attractiveness of Kant's theory, critics have argued that, like utilitarianism, it has its limitations and inadequacies. A first problem that critics have traditionally pointed out is that Kant's theory is not clear enough to always be useful. One difficulty lies in trying to determine whether one would (as the first formulation requires) "be willing to have everyone follow" a certain policy. Although the general thrust of this requirement is usually clear, it sometimes leads to problems. For example, suppose I am a murderer, would 1 then be willing to have everyone follow the policy that all murderers should be punished? In a sense I would be willing to because, I would want to be protected from other murderers, but in another sense I would not be willing because I do not want to be punished myself. Which sense is correct?

It is also sometimes difficult to determine whether (as the second formulation states) one person is using another "merely as a means." Suppose, for example, that Ms. Jones, an employer, only pays minimum wages to her employees and refuses to install the safety equipment they want, yet she says she is “respecting their capacity to freely choose for themselves” because, she is willing to let them work elsewhere if they choose. Is she then treating them merely as means or also as ends? Critics complain that they cannot answer such questions because Kant's theory is too vague. There are cases, then, where the requirements of Kant's theory are unclear.

Second, some critics claim that, although we might be able to agree on the kinds of interests that have the status of moral rights, there is substantial disagreement concerning what the limits of each of these rights are and concerning how each of these rights should be balanced against other conflicting rights. Kant's theory does not help us resolve these disagreements. For example, we all agree that everyone should have a right to associate with whomever they want, as well as a right not to be injured by others. However, how should these rights be balanced

against each other when a certain association of people begins to injure others? For example, suppose the loud music of a group of trombone players disturbs others, or suppose a corporation (which is an association of people) pollutes the air and water on which the health of others depends. Kant's categorical imperative does not tell us how the conflicting rights of these persons should be adjusted to each other: Which right should be limited in favour of the other?

A defender of Kant, however, can counter this second criticism by holding that Kant's categorical imperative is not intended to tell us how conflicting rights should be limited and adjusted to each other. To decide whether one right should be curtailed in favour of a second right, one has to examine the relative importance of the interests that each right protects. What arguments can be given to show, for example, that a corporation's interest in financial gains is more or less important than the health of its neighbours? The answer to this question determines whether a corporation's right to use its property for financial gains should be limited in favour of its neighbours' right not to have their health injured. All that Kant's categorical imperative is meant to tell us is that everyone must have equal moral rights and everyone must show as much respect for the protected interests of others as they want others to show for their own. It does not tell us what interest's people have or what their relative importance is.

A third group of criticisms that have been made of Kant's theory is that there are counter examples that which show that the theory sometimes goes wrong. Most counter examples to Kant's theory focus on the criteria of universality and reversibility. Suppose that an employer can get away with discriminating against women by paying them lower wages than men for the same work. Suppose also that he is so fanatical in his dislike of women that he is willing to accept the proposition that if his own sex were female, employers should also discriminate against him. Then, according to Kant's theory, the employer would be acting morally. According to the critics, this is wrong because discrimination is obviously immoral.

Defenders of a Kantian approach to ethics, of course, would reply that it is the critics, not Kant, who is mistaken. If the employer genuinely and conscientiously would be willing to universalise the principles on which he is acting, then the action is in fact morally right for him. For us, who would be unwilling to universalise the same principle, the action would be immoral. We may also find that it would be morally right for us to impose sanctions on the employer to make him stop discriminating. Insofar as the employer is trying to remain true to his own universal principles, he is acting conscientiously and, therefore, in a moral manner.

3.3.7 The Libertarian Objection: Nozick

Some important views on rights that are different from the ones we have sketched have been proposed recently by several libertarian philosophers. Libertarian philosophers go beyond the general presumption that freedom from human constraint is usually good; they claim that such freedom is necessarily good and that all constraints imposed by others are necessarily evil except when needed to prevent the imposition of greater human constraints. The American philosopher Robert Nozick, for example, claims that the only basic right that every individual possesses is the negative right to be free from the coercion of other human beings. This negative right to freedom from coercion, according to Nozick, must be recognised if individuals are to be treated as distinct persons with separate lives, each of whom has an equal moral weight that may not be sacrificed for the sake of others. The only circumstance under which coercion may be exerted on a person is when it is necessary to keep that person from coercing others.

According to Nozick, prohibiting people from coercing others constitutes a legitimate moral constraint that rests on “the underlying Kantian principle that individuals are ends and not merely means; they may not be sacrificed or used for achieving other ends without their consent.” Thus, Nozick seems to hold that Kant's theory supports his own views on freedom.

Nozick and other libertarians, however, pass too quickly over the fact that the freedom of one person necessarily imposes constraints on other persons. Such constraints are inevitable because when one person is granted freedom, other persons must be constrained from interfering with that person on it and taking it from him/her. Even the "free market system" that Nozick advocates depend from trespassing on an underlying system of coercion: I can sell something only if I first own it, and ownership depends essentially on an enforced (coercive) system of property laws. Consequently, because granting a freedom to one person necessarily imposes constraints on others, it follows that if constraints require justification, freedom will also always require justification.

SELF ASSESSMENT EXERCISE

1. What do you understand by utilitarianism?
2. What do you understand by rights and duties?

4.0 CONCLUSION

Utilitarianism is a general term for any view that holds that action and policies should be evaluated on the basis of the benefit and costs they

will impose on society, while utility is the inclusive term used to refer to any net benefit produced by an action.

5.0 SUMMARY

The requirement that everyone should be related as a free person equal to everyone else means categorical imperative, while believe that necessary freedom from human constraint is necessarily good and that all constraints imposed by others are necessarily evil except when needed to prevent the imposition of greater human constraints.

6.0 TUTOR–MARKED ASSIGNMENT

1. A student incorrectly defined utilitarianism this way "Utilitarianism is the view that so long as an action provides me with more measurable economic benefits than costs, the action is morally right." Identify all of the mistakes contained in this definition of utilitarianism.
2. In your view, does utilitarianism provide a more objective standard for determining right and wrong than moral rights do? Explain your answer fully. Does utilitarianism provide a more objective standard than the principle of justice?

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MODULE 2

Unit 1 Ethics, Justice and Business
Unit 2 Business System I
Unit 3 Business System II
Unit 4 Ethics and Environmentalism

UNIT 1 ETHICS, JUSTICE AND BUSINESS

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1.0 INTRODUCTION

This unit introduces you to Ethics, Justice and its relationship in the market place. Kantian principles is of the opinion that, the dignity of each person should be respected and that, each person's capacity to choose freely should be developed. Because we have these duties to each other, government coercion is legitimate whenever it is needed to ensure, that the dignity of citizens is being respected or when it is needed to secure the full development of people's capacity to chose. This, as Kant argues, means that government may legitimately place limits on the use of property and on the making of contracts and impose market restrictions and compulsory taxes when these are needed to care for the welfare or development of persons "who are not able to support themselves." We have no reason to think that only negative rights exist. People can also have positive rights, and Kant's theory supports these as much as it supports negative rights.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain justice and fairness;
- describe capitalist justice;
- explain socialism;
- explain compensatory justice.

3.0 MAIN CONTENT

3.1 Justice and Fairness

Disputes among individuals in business are often interlaced with references to justice or fairness. This is the case, for example, when one person accuses another of unjustly discriminating against him or her, showing unjust favoritism toward someone else, or not taking up a fair share of the burden involved in some cooperative venture. Resolving disputes like these requires that we compare and weigh the conflicting claims of each of the parties and strike a balance between them. Justice and fairness are essentially comparative. They are concerned with the comparative treatment given to the members of a group when benefits and burdens are distributed, when rules and laws are administered, when members of a group cooperate or compete with each other, and when people are punished for the wrongs they have done or compensated for the wrongs they have suffered. Although the terms justice and fairness are used almost interchangeably, we tend to reserve the word justice for matters that are especially serious, although some authors have held that the concept of fairness is more fundamental.

Standards of justice are generally taken to be more important than utilitarian considerations. If a society is unjust to some of its members, then we normally condemn that society, even if the injustices secure more utilitarian benefits for everyone. If we think that slavery is unjust, for example, then we condemn a society that uses slavery even if slavery makes that society more productive. Greater benefits for some cannot justify injustices for others. Nonetheless, we also seem to hold that if the social gains are sufficiently large, a certain level of injustice may legitimately be tolerated. In countries with extreme deprivation and poverty, for example, we seem to hold that some degree of equality may be traded off for major economic gains that leave everyone better off.

Standards of justice do not generally override the moral rights of individuals. Part of the reason for this is that, to some extent, justice is based on individual moral rights. The moral right to be treated as a free and equal person, for example, is part of what lies behind the idea that

benefits and burdens should be distributed equally. More important, however, is the fact that, as we saw, a moral right identifies interests people have, the free pursuit of which may not be subordinated to the interests of others except where there are special and exceptionally weighty reasons. This means that, for the most part, the moral rights of some individuals cannot be sacrificed merely in order to secure, a somewhat better distribution of benefits for others. However, correcting extreme injustices may justify restricting some individuals' rights. Property rights, for example, might be legitimately redistributed for the sake of justice. We discuss trade-offs of this sort more fully after we have a better idea of what *justice* means.

Issues involving questions of justice and fairness are usually divided into three categories. Distributive justice, the first and basic category, is concerned with the fair distribution of society's benefits and burdens. In the brown lung hearings, for example, Senator Thurmond pointed out that if federal law helped workers afflicted by black lung, then it was only “fair” that it also help workers afflicted by brown lung. Another example drawn from our immediate environment is the implementation of monetisation across both senior and junior categories of workers with the Federal Government of Nigeria.

Retributive justice, the second category, refers to the just imposition of punishments and penalties on those who do wrong: A just penalty is one that in some sense is deserved by the person who does wrong. Retributive justice would be at issue, for example, if we were to ask whether it would be fair to penalise cotton mills for causing brown lung disease among their workers. Compensatory justice, the third category, concerns the just way of compensating people for what they lost when they were wronged by others: A just compensation is one that in some sense is proportional to the loss suffered by the person being compensated (such as loss of livelihood).

3.2 Distributive Justice

Questions of distributive justice arise when different people put forth conflicting claims on society's benefits and burdens and all the claims cannot be satisfied. The central cases are those where there is a scarcity of benefits-such as jobs, food, housing, medical care, income, and wealth-as compared with the numbers and desires of the people who want these goods. The other side of the coin is that there may be too many burdens-unpleasant work, drudgery, substandard housing, health injuries of various sorts-and not enough people willing to shoulder them. If there were enough goods to satisfy everyone's desires and enough people willing to share society's burdens, then conflicts between people would not arise and distributive justice would not be needed.

When people's desires and aversions exceed the adequacy of their resources, they are forced to develop principles for allocating scarce benefits and undesirable burdens in ways that are just and that resolve the conflicts in a fair way. The development of such principles is the concern of distributive justice.

The fundamental principle of distributive justice is that, equals should be treated equally and unequal treated unequally. More precisely, the fundamental principle of distributive justice may be expressed as follows:

Individuals who are similar in all respects relevant to the kind of treatment in question should be given similar benefits and burdens, even if they are dissimilar in other irrelevant respects; and individuals who are dissimilar in a relevant respect ought to be treated dissimilarly, in proportion to their dissimilarity:

3.3 Justice Based on Contribution: Capitalist Justice

Some writers have argued that a society's benefits should be distributed in proportion to what each individual contributes to a society and/or to a group. The more a person contributes to a society's pool of economic goods, for example, the more that person is entitled to take from that pool; the less an individual contributes, the less that individual should get. The more a worker contributes to a project, the more that worker should be paid. According to this capitalist view of justice, when people engage in economic exchanges with each other, what a person gets out of the exchange should be at least equal in value to what the person contributed. Justice requires, then, that the benefits people receive should be proportional to the value of their contribution.

Benefits should be distributed according to the value of the contribution the individual makes to a society, a task, a group, or an exchange. The principle of contribution is perhaps the principle of fairness most widely used to establish salaries and wages. In workgroups, particularly when relationships among the members of the group are impersonal and the product of each worker is independent of the efforts of the others, workers tend to feel that they should be paid in proportion to the work they have contributed. Salespeople out on the road, for example, or workers at individual sewing machines sewing individual garments or doing other piecework tend to feel that they should be paid in proportion to the quantity of goods they have individually sold or made. Interestingly, when workers are paid in accordance with the principle of contribution, this tends to promote among them an uncooperative and even competitive atmosphere in which resources and information are less willingly shared and in which status differences emerge. Workers in

countries that are characterised as having a more individualistic culture, such as the United States, prefer the principle of contribution more than workers in countries that are characterised as having a more collectivist culture, such as Japan.

The main question raised by the contributive principle of distributive justice is how the "value of the contribution" of each individual is to be measured. One long lived tradition has held that contributions should be measured in terms of *work effort.* The more effort people put forth in their work, the greater the share of benefits to which they are entitled. The harder one works, the more one deserves. This is the assumption behind the **Puritan** ethic, which held that individuals had a religious obligation to work hard at their *calling* (the career to which God summons each individual) and that God justly rewards hard work with wealth and success, while He justly punishes laziness with poverty and failure. In the United States, this Puritan ethic has evolved into a secularised work ethic, which places a high value on individual effort and which assumes that, whereas hard work does, and should lead to success, loafing is and should be punished.

However, there are many problems with using effort as the basis of distribution. First, to reward a person's efforts without any reference to whether the person produces anything worthwhile through these efforts is to reward incompetence and inefficiency. Second, if we reward people solely for their efforts and ignore their abilities and relative productivity, then talented and highly productive people will be given little incentive to invest their talent and productivity in producing goods for society. As a result, society's welfare will decline.

A second important tradition has held that contributions should be measured in terms of productivity: The greater the quantity of a person's contributed product, the more that person should receive. *(Product* here should be interpreted broadly to include services rendered, capital invested, commodities manufactured, and any type of literary, scientific, or aesthetic works produced.) A major problem with this second proposal is that it ignores people's needs. Handicapped, ill, untrained, and immature persons may be unable to produce anything worthwhile; if people are rewarded on the basis of their productivity, the needs of these disadvantaged groups will not be met. The main problem with this second proposal is that it is difficult to place any objective measure on the value of a person's product, especially in fields such as the sciences, the arts, entertainment, athletics, education, theology, and health care. Who would want to have their products priced on the basis of someone else's subjective estimates?

To deal with the last difficulty mentioned, some authors have suggested a third and highly influential version of the principle of contribution: They have argued that the value of a person’s product should be determined by the market forces of supply and demand. The value of a product would then depend not on its intrinsic value, but on the extent to which it is both relatively scarce and is viewed by buyers as desirable. In other words, the value of a person’s contribution is equal to whatever that contribution would sell for in a competitive market. People then deserve to receive in exchange with others whatever the market value of their product is worth.

Unfortunately, this method of measuring the value of a person’s product still ignores people’s needs. Moreover, to many people, market prices are an unjust method of evaluating the value of a person's product precisely because markets ignore the intrinsic values of things. Markets, for example, reward entertainers more than doctors. Also, markets often reward a person who, through pure chance, has ended with something (e.g., an inheritance) that is scarce and that people happen to want. This, to many, seems the height of injustice.

3.4 Justice Based on Needs and Abilities: Socialism

Because there are probably as many kinds of socialism as there are socialists, it is somewhat inaccurate to speak of "the" socialist position on distributive justice. Nonetheless, the dictum proposed first by Louis Blanc (1811-1882) and then by Karl Marx (1818-1883) and Nikolai Lenin (1870-1924) is traditionally taken to represent the socialist view on distribution: “From each according to his ability, to each according to his needs.” The socialist principle, then, can be paraphrased as follows: Work burdens should be distributed according to people's abilities, and benefits should be distributed according to people’s needs.

This socialist principle is based first on the idea that people realise their human potential by exercising their abilities in productive work. Because the realisation of one's full potentiality is a value, work should be distributed in such a way that a person can be as productive as possible, and this implies distributing work according to ability. Second, the benefits produced through work should be used to promote human happiness and well-being. This means distributing them so that people's basic biological and health needs are met and then using what is left over to meet people's other, non basic needs. Perhaps most fundamental to the socialist view is the notion that societies should be communities in which benefits and burdens are distributed on the model of a family. Just as able family members willingly support the family, and just as needy family members are willingly supported by the family, so also the able members of a society should contribute their abilities to society by

taking up its burdens while the needy should be allowed to share in its benefits.

As the example of the family suggests, the principle of distribution according to need and ability is used within small groups as well as within larger society. In athletics, for example, the members of a team will distribute burdens according to each athlete's ability and will tend to stand together and help each other according to each one's need. The principle of need and ability, however, is the principle that tends to be least acknowledged in business. Managers sometimes invoke the principle when they pass out the more difficult jobs among the members of a workgroup to those who are stronger and more able, but they often retreat when these workers complain that they are being given larger burdens without higher compensation. Managers also sometimes invoke the principle when they make special allowances for workers who seem to have special needs. However, they rarely do so and are often criticised for showing favouritism when they do this.

Nevertheless, there is something to be said for the socialist principle: Needs and abilities certainly should be taken into account, when determining how benefits and burdens should be distributed among the members of a group or society. Most people would agree, for example, that we should make a greater contribution to the lives of cotton mill workers with brown lung disease who have greater needs than to the lives of healthy persons who have all they need. Most people would also agree that individuals should be employed in occupations for which they are fitted, and that this means matching each person's abilities to a job as far as possible. Vocational tests in junior secondary school for example, are supposed to help students find careers that match their abilities.

However, the socialist principle has also had its critics. First, opponents have pointed out that, under the socialist principle, there would be no relation between the amount of effort a worker puts forth and the amount of remuneration the worker receives (because remuneration would depend on need, not on effort). Consequently, opponents conclude, workers would have no incentive to put forth any work efforts at all knowing that they will receive the same regardless of whether they work hard. The result, it is claimed, will be a stagnating economy with a declining productivity (a claim, however, that does not seem to be borne out by the facts). Underlying this criticism is a deeper objection-namely, that it is unrealistic to think that entire societies could be modeled on familial relationships. Human nature is essentially self-interested and competitive, the critics of socialism hold, and so outside the family people cannot be motivated by the fraternal willingness to share and help that is characteristic of families.

Socialists have usually replied to this charge by arguing that human beings are trained to acquire the vices of selfishness and competitiveness by modern social and economic institutions that inculcate and encourage competitive and self-interested behavior, but that people do not have these vices by nature. By nature, humans are born into families where they instinctively value helping each other. If these instinctive and “natural” attitudes continued to be nurtured, instead of being eradicated, humans would continue to value helping others even outside the family and would acquire the virtues of being cooperative, helpful, and selfless. The debate on what kinds of motivations human nature is subject to is still largely unsettled.

A second objection that opponents of the socialist principle have urged is that, if the socialist principle were enforced, it would obliterate individual freedom. Under the socialist principle, the occupation each person entered would be determined by the person's abilities and not by free choice. If a person has the ability to be a university teacher but wants to be a ditch digger, the person will have to become a teacher. Similarly, under the socialist principle, the goods a person gets will be determined by the person’s needs and not by free choice. If a person needs a loaf of bread but wants a bottle of beer, the person will have to take the loaf of bread.

The sacrifice of freedom is even greater, the critics claim, when one considers that in a socialist society some central government agency has to decide what tasks should be matched to each person's abilities and what goods should be allotted to each person's needs. The decisions of this central agency will then have to be imposed on other persons at the expense of their freedom to choose for themselves. The socialist principle substitutes paternalism for freedom.

3.5 Retributive Justice

Retributive justice concerns the justice of blaming or punishing persons for doing wrong. Philosophers have long debated the justification of blame and punishment, but we need not enter these debates here. More relevant to our purposes is the question of the conditions under which it is just to punish a person for doing wrong.

The first unit discussed some major conditions under which people could not be held morally responsible for what they did: ignorance and inability. These conditions are also relevant to determining the justice of punishing or blaming someone for doing wrong: If people do not know or freely choose what they are doing, they cannot justly be punished or blamed for it.

A second kind of condition of just punishments is certitude that the person being punished actually did wrong. For example, many firms use more or less complex systems of due process that are intended to ascertain whether the conduct of employees was realty such as to merit dismissal or some other penalty. Penalising an employee on the basis of flimsy or incomplete evidence is rightly considered an injustice.

A third kind of condition of just punishments is that they must be consistent and proportioned to the wrong. Punishment is consistent only when everyone is given the same penalty for the same infraction; punishment is proportioned to the wrong when the penalty is no greater in magnitude than the harm that the wrongdoer inflicted. It is unjust, for example, for a manager to impose harsh penalties for minor infractions of rules or to be lenient toward favourites but harsh toward all others. If the purpose of a punishment is to deter others from committing the same wrong or to prevent the wrongdoer from repeating the wrong, then punishment should not be greater than what is consistently necessary to achieve these aims.

3.6 Compensatory Justice

Compensatory justice concerns the justice of restoring to a person what the person lost when wronged by someone else. We generally hold that when one person wrongfully harms the interests of another person, the wrong doer has a moral duty to provide some form of restitution to the person wronged. For example, if I destroy someone's property or injure him bodily, I will be held morally responsible for paying him damages.

There are no hard and fast rules for determining how much compensation a wrong doer owes the victim. Justice seems to require that the wrong doer as far as possible should restore whatever was taken, and this would usually mean that the amount of restitution should be equal to the loss the wrong doer knowingly inflicted on the victim.

However, some losses are impossible to measure. If I maliciously injure someone's reputation, for example, how much restitution should I make? Some losses, moreover, cannot be restored at all: How can the loss of life or the loss of sight be compensated? In situations such as the Ford Pinto case, where the injury is such that full restoration of the loss, is not possible, we seem to hold that the wrong doer should at least pay for the material damages the loss inflicts on the injured person and the immediate family.

Traditional moralists have argued that a person has a moral obligation to compensate an injured party only if three conditions are present.

- The action that inflicted the injury was wrong or negligent. For example, if by efficiently managing my firm I undersell my competitor and run her out of business, I am not morally bound to compensate her since such competition is neither wrongful nor negligent; but if I steal from my employer, then I owe him compensation, or if I fail to exercise due care in my driving, then I owe compensation to those whom I injure.

- The person's action was the real cause of the injury. For example, if a banker loans person money and the borrower then uses it to cheat others, the banker is not morally obligated to compensate the victims; but if the banker defrauds a customer, the customer must be compensated.

- The person inflicted the injury voluntarily. For example, if I injure someone's property accidentally and without negligence, I am not morally obligated to compensate the person. (I may, however, be legally bound to do so depending on how the law chooses to distribute the social costs of injury.)

SELF ASSESSMENT EXERCISE

Differentiate between Distributive Justice and Compensatory Justice.

4.0 CONCLUSION

The most controversial forms of compensation undoubtedly are the preferential treatment programmes that attempt to remedy past injustices against groups. For example, if a racial group has been unjustly discriminated against for an extended period of time in the past and its members consequently now hold the lowest economic and social positions in society, does justice require that members of that group be compensated by being given special preference in hiring, training, and promotion procedures? Would such special treatment be a violation of justice by violating the principle of equal treatment?

5.0 SUMMARY

Does justice legitimise quota even if this requires turning down more highly qualified non minorities? This is a complex and involved question that we are not able to answer at this point. We will return to it in a later unit.

6.0 TUTOR-MARKED ASSIGNMENT

Write short note on the following concepts:

- distributive justice
- capitalist justice
- socialist justice
- compensatory justice

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UNIT 2 BUSINESS SYSTEM I

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1.0 INTRODUCTION

The second unit is centred on the economic systems: the free market, its rights and utilities as explained by John Locke and Adam smith. However, their explanation never went without criticism as forwarded by Keynes. Also, the unit explained the utility of the survival of the fittest from the angle of Social Darwinism.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain why government must leave people free to exchange their property;
- state why Adam Smith believes that free market produces results and should be consistent with the public good;
- examine the Keynesian criticism

3.0 MAIN CONTENT

3.1 Economic Systems

Arguments about free markets and free trade are arguments about economic systems. An economic system is the system a society uses to provide the goods and services it needs to survive and flourish. This

system must accomplish two basic economic tasks: First is the task of actually producing goods and services, which requires determining what will be produced, how it will be produced, and who will produce it. The second is the task of distributing these goods and services among its members, which requires determining who will get what and how much each will get. To accomplish these two tasks, economic systems rely on three kinds of social devices: traditions, commands, and markets. Each of these three provides a way to organise people’s activities, a way to motivate them, and a way to decide who owns or controls the society’s productive resources.

The so-called primitive societies used economic systems based primarily on tradition. Tradition-based societies are small and rely on traditional communal roles and customs to carry out the two basic economic tasks. Individuals are motivated by the community's expressions of approval or disapproval, and the community's productive resources, such as its herds are often owned in common. A small nomadic tribe, for example, that survives by hunting and herding might rely on the traditional roles of husband, wife, mother, father, son, and daughter to decide who does what and who gets what and may hold its herd in common. Societies that are almost completely tradition-based exist even today among Bushmen, the Inuit, Kalahari hunters, and Bedouin tribes.

Large modern societies carry out the two main economic tasks primarily through two very distinctive ways of organising themselves: commands and markets.; In an economic system based primarily on commands, a government authority (a person or a group) makes the economic decisions about what is to be produced, who will produce it, and who will get it. Productive resources such as land and factories are owned or controlled by government and are considered to belong to the public or to “the people.” Individuals are motivated to put forth the required effort by the rewards and punishments government doles out and by its exhortations to serve society. China, Vietnam, North Korea, Cuba, the former Soviet Union, and several other nations have run their economies primarily on the basis of commands.

By contrast, in a system based primarily on markets, private individuals make the main decisions about what they will produce and who will get it. Productive resources like land and factories are owned and managed by private individuals and are consequently considered “private property.” People are motivated to work primarily by the desire to get paid for voluntarily supplying the things others are willing to pay for. England in the 19th century is often cited as a prime example of an economy that was based primarily on a market system.

Economies today contain elements of all three of these devices: traditions, commands, and markets The United States, for example, is highly "market-oriented," yet some Americans still consider some jobs to be "men's work," or "women's work," so for them "tradition" determines who does those jobs, and the U.S. government not only issues "commands" that regulate business, labour, and international trade but also owns several important businesses, including the Export-Import Bank, the Postal Service, the Tennessee Valley Authority, and several others.

In fact, it would be undesirable to run an economy completely on the basis of traditions, commands, or markets. If an economy was a pure market system, for example, with no economic interventions by government, there would be no constraints whatsoever on the property one could own or what one could do with it. Slavery would be entirely legal, as would prostitution and all drugs, including hard drugs. Today, the governments of even the most market-oriented economies decree that there are some things that may not be owned (such as slaves), some things that may not be done with one's own property (such as pollution), some exchanges that are illegal (children's labour), and some exchanges that are imposed (through taxation). Such limitations on markets are intrusions of a command system: Government concern for the public welfare leads it to issue commands concerning which goods may or may not be produced or exchanged. Similarly, even under the almost all-encompassing command system of the former Soviet Union's harsh Stalinist regime, local markets-many of them so called "black markets"-existed where workers could trade their wages for the goods they wanted.

Since the 18th century, debates have raged over whether economies should be based more on commands or on markets. Should we have more government commands in the form of more economic regulations and more government control of business enterprises, or should government stand back and trust the economy more to the workings of the "market" and the decisions of private owners of companies? Sometimes these debates have been expressed in terms of whether economic activities should be more or less "free" of government "intrusions" and then the discussion is over "free markets" ("free," that is, of government) and "free trade." Sometimes the debate is over "laissez-faire" policies, which, literally, in French is for policies that "let us act" free of government controls.

Today these debates continue on two levels:

- Arguments for and against "free markets" within a nation,
- Arguments for and against "free trade" between nations. The

reader should not confuse the two different levels of these debates, although the two levels are related. The debate at the first level asks whether a nation's government should regulate business exchanges between its citizens or, instead, allow its citizens to freely exchange goods with each other. The debate at the second level asks whether a nation's government should allow its citizens to freely trade goods with the citizens of other nations or, instead, impose tariffs or quotas on the goods foreign citizens want to trade with them. We can call the first debate the debate over free markets and the second the debate over free trade. In this unit, we will examine the arguments on both sides of these debates, which are, in the end, debates over the proper role of commands and of markets both nationally and internationally.

In analysing these arguments on free markets and free trade, on commands and markets, we in effect analyse what sociologists refer to as ideologies. An **ideology** is a system of normative beliefs shared by members of some social group. The ideology expresses the group's answers to questions about human nature (e.g., Are human beings only motivated by economic incentives?), the basic purpose of our social institutions (e.g., what is the purpose of government; of business, of the market?); how societies actually function (e.g., are markets really free? Does big business control government?), and the values society should try to protect (e.g., freedom, productivity, equality etc). A business ideology, then, is a normative system of beliefs on these matters, but specifically one that is held by business groups such as managers.

The importance of analysing business ideologies is obvious: A businessperson's ideology often determines the business decisions made; through these decisions, the ideology influences the person's behaviour. The businessperson's ideology, for example, will colour the person's perceptions of the groups with whom the person has to deal (employees, government officials, the poor, competitors, consumers); it will encourage the person to give in to certain pressures from these groups (perhaps even to support them) and oppose others; it will make the person look on some actions as justified and legitimate and other actions (both those of the person and those of other groups) as unjustified and illegitimate. If a person's ideology is never examined, it will nonetheless have a deep and pervasive influence on the person's decision-making, an influence that may go largely unnoticed and that may derive from what is actually a false and ethically objectionable ideology.

The ideologies that Americans hold today incorporate ideas drawn from the thinking of Adam Smith, John Locke, David Ricardo, and other influential thinkers whose normative views we examine and evaluate in this unit. We discuss these ideas not only because of the significant

influence they have on our ideologies but because many people today argue that these ideologies must be adjusted if they are to meet the contemporary needs of business and society. It would be a valuable exercise for the reader to identify the ideology he or she holds and to examine and criticise its elements when reading this unit.

3.2 Free Markets and Rights: John Locke

One of the strongest cases for an unregulated market derives from the idea that human beings have certain "natural rights" that only a free market system can preserve. The two natural rights that free markets are supposed to protect are the right to freedom and the right to private property. Free markets are supposed to preserve the right to freedom insofar as they enable each individual to voluntarily exchange goods with others free from the coercive power of government. They are supposed to preserve the right to private property insofar as each individual is free to decide what will be done with what he or she owns without interference from government.

John Locke (1632-1704), an English political philosopher, is generally credited with developing the idea that human beings have a “natural right” to liberty and a “natural right” to private property. Locke argued that if there were no governments, human beings would find themselves in a state of nature. In this state of nature, each individual would be the political equal of all others and would be perfectly free of any constraints other than the law of nature-that is, the moral principles that God gave to humanity and that each individual can discover by the use of God-given reason. As he puts it, “in a state of nature, everyone would be in a state of perfect freedom to order their actions and dispose of their possessions and persons as they think fit, within the bounds of the law of nature, without asking leave, or depending upon the will of any other man. A state is also of equality, wherein all the power and jurisdiction are reciprocal, no one having more than another without subordination or subjection to another. But the state of nature has a law of nature to govern it, which obliges everyone: and reason, which is that law, teaches all mankind, who will but consult it, that being all equal and independent, no one ought to harm another in his life, health, liberty, or possessions”.

Although Locke never explicitly used his theory of natural rights to argue for free markets, several 20th-century authors have employed his theory for this purpose. Friedrich A. Hayek, Murray Rothbard, Gottfried Dietze, Eric Mack, and many others have claimed that each person has the right to liberty and property that Locke credited to every human being and that; consequently, government must leave individuals free to exchange their labour and their property as they voluntarily choose.

Only a free private enterprise exchange economy, in which government stays out of the market and in which government protects the property rights of private individuals, allows for such voluntary exchanges. The existence of the Lockean rights to liberty and property, then, implies that societies should incorporate private property institutions and free markets.

Government does not grant or create private property rights. Instead, it must respect and protect the property rights that are naturally generated through labour and trade. It is only relatively recently, in the late 19th and 20th centuries, that this Lockean view began to give way in the United States to the more "socialist" view that government may limit an individual's private property rights for the good of society.

Even today in the United States there is a strong presumption that government does not create property rights, but must respect and enforce the property rights that individuals create through their own efforts. It is important to see that this American and Lockean view of property is not universal. In some countries, such as Japan, resources are not seen as things over which individuals have an absolute private property right. Instead, in Japan, as in other Asian societies, resources are seen as functioning primarily to serve the needs of society as a whole, and so the property rights of individuals should give way to the needs of society when there is a conflict between the two.

Locke’s view that, when a person expends labour and effort to create or improve a thing, that person acquires property rights over that thing. If a person writes a book or software program, for example, then that book or software program is the property of the person who "mixed" labour into it. A person may, of course, agree to "sell" labour to an employer, and thereby agree that the employer will gain ownership of whatever the person creates. However, even such employee agreements assume that the employee has the right to "sell" labour, and this means that the employee must have been the original owner of the labour used to create the object. Software developers, for example, are the rightful owners of the software programmes they develop not only because they have invested a great deal of time and energy into developing these programs but also because they have paid the software engineers who "sold" them their labour to produce these programmes. We should notice that these views on property all assume, of course, that a private property right is really a bundle of rights. To say that X is my private property is to say that I have a right to use it, consume it, sell it, give it away, loan it, rent it, keep anything of value it produces, change it, destroy it, and, most important, exclude others from doing any of these things without my consent.

3.2.1 Criticisms of Lockean Rights

Criticisms of the Lockean defense of free markets have focused on four of its major weaknesses: (a) the assumption that individuals have the "natural rights" Locke claimed they have, (b) the conflict between these negative rights and positive rights, (c) the conflict between these Lockean rights and the principles of justice, and (d) the individualistic assumptions Locke makes and their conflict with the demands of caring.

First, the Lockean defence of free markets rests on the unproven assumption that people have rights to liberty and property that take precedence over all other rights. If humans do not have the overriding rights to liberty and property, then the fact that free markets would preserve the rights does not mean a great deal. Neither Locke nor his 20th-Century followers, however, have provided the arguments needed to establish that human beings have such "natural" rights. Locke merely asserted that, "reason . . . teaches all mankind, who will but consult it" that these rights exist. Instead of arguing for these rights, therefore, Locke had to fall back on the bare assertion that the existence of these rights is "self-evident": All rational human beings are supposed to be able to intuit that the alleged rights to liberty and to property exist. Unfortunately, many rational human beings have tried and failed to have this intuition.

The problem emerges most clearly if we look more closely at Locke's views on the natural right to property. Locke claims that when a person "mixes" labour into some object that is unclaimed, the object becomes that person's property. For example, if I find a piece of driftwood on seashore and whittle it into a pretty statue, the statue becomes my property because I have taken something of mine-my labour-and "mixed" it into the wood so as to make it more valuable. Investing effort and work into making something more valuable makes that thing mine. But why should this be? As the philosopher Robert Nozick has asked, if I "mix" my labour into something that is not yet mine, then why isn't this just a way of losing my labour?

Suppose that I own a cup of water and I throw my cup of water into the ocean so that I mix my water with the unknown water of the ocean. Does the ocean become "mine"? Clearly, in this case at least, mixing something of mine into something that is not mine is merely a way of losing what was mine, not a way of acquiring something that was not mine. Why is it that when I invest my work in improving or changing an object so as to make it more valuable, that object becomes my "property"? Locke provides no answer to this question, apparently thinking that it is "self-evident."

Second, even if human beings have a natural right to liberty and property, it does not follow that this right must override all other rights. The right to liberty and property is a "negative" right; negative rights can conflict with people's positive rights. For example, the negative right to liberty may conflict with someone else's positive right to food, medical care, housing, or clean air. Why must we believe that in such cases the negative right has greater priority than the positive right? Critics argue, in fact, that we have no reason to believe that the rights to liberty and property are overriding. Consequently, we also have no reason to be persuaded by the argument that free markets must be preserved because they protect this alleged right.

The third major criticism of the Lockean defence of free markets is based on the idea that free markets create unjust inequalities. In a free market economy, a person's productive power is proportioned to the amount of labour or property already possessed. Those individuals who have accumulated a great deal of wealth and who have access to education and training will be able to accumulate even more wealth by purchasing more productive assets. Individuals who own no property, who are unable to work, or who are unskilled (such as the handicapped, infirm, poor, aged) will be unable to buy any goods at all without help from the government. As a result, without government intervention, the gap between the richest and poorest will widen until large disparities of wealth emerge. Unless government intervenes to adjust the distribution of property that results from free markets, large groups of citizens will remain at a subsistence level while others grow ever wealthier. To prove their point, critics cite the high poverty levels and large inequalities evident in “capitalist” nations such as the United States.

Finally, critics have argued, Locke's argument assumes human beings are atomistic individuals with personal rights to liberty and property that flow from their personal nature independently of their relations to the larger community. Because these rights are assumed to be prior to and independent of the community, the community can make no claims on the property or freedom of the individual. However, critics claim that these individualistic assumptions are completely false: They ignore the key role of caring relationships in human societies and the demands of caring that arise from these relationships.

Critics of Locke point out that human being are born dependent on the care of others; as they grow, they remain dependent on the care of others to acquire what they need to become able adults. Even when they become adults, they depend on the caring cooperation of others in their communities for virtually everything they do or produce. The degree of liberty a person has depends on what the person can do: The less a person can do. The less he is free to do. But a person’s abilities depend

on what he learns from those who care for him as well as on what others care to help him to do or allow him to do.

Similarly, the “property” that a person produces through labour depends ultimately on the skills acquired from those who cared for him and on the cooperative work of others in the community such as employees. Even one's identity---one’s sense of who one is as a member of the various communities and groups to which one belongs depends on one's relationships with others in the community. In short, the individualistic assumption built into Locke’s view of human beings ignores the concrete caring relationships from which a person's identity and the possibility of individual rights arise.

Humans are not atomistic individuals with rights that are independent of others; instead, they are persons embedded in caring relationships that make those rights possible and that make the person who and what he or she is. Moreover, critics continue, persons are morally required to sustain these relationships and to care for others as others have cared for them. The community can legitimately make claims on the property of individuals and can restrict the freedom of individuals precisely because the community and the caring it has provided are the ultimate source of that property and freedom.

3.3 Free Markets and Utility: Adam Smith

The second major defence of unregulated markets rests on the utilitarian argument that unregulated markets and private property will produce greater benefits than any amount of regulation could. In a system with free markets and private property, buyers will seek to purchase what they want for themselves at the lowest prices they can find. Therefore, it will pay private businesses to produce and sell what consumers want and it will do this at the lowest possible prices. To keep their prices down, private businesses will try to cut back on the costly resources they consume. Thus, the free market, coupled with private property, ensures that the economy is producing what consumers want, that prices are at the lowest levels possible, and that resources are efficiently used. The economic utility of society's members is thereby maximised.

Adam Smith (1723-1790), the "father of modern economics," is the originator of this utilitarian argument for the free market. According to Smith, when private individuals are left free to seek their own interests in free markets, they will inevitably be led to further the public welfare by an invisible hand. The "invisible hand," of course, is market competition. Every producer seeks to make a living by using private resources to produce and sell those goods that the producer perceives people want to buy. In a competitive market, a multiplicity of such

private businesses must all compete with each other for the same buyers.

To attract customers, therefore, each seller is forced not only to supply what consumers want but to drop the price of goods as close as possible to "what it really costs the person who brings it to market." To increase one's profits, each producer must pare costs, thereby reducing the resources consumed. The competition produced by a multiplicity of self-interested private sellers serves to lower prices, conserve resources, and make producers respond to consumer desires. Motivated only by self-interest, private businesses are led to serve society. Smith puts the matter in a famous passage.

- It is not from the benevolence of the butcher, the baker, and the brewer that we expect our dinner, but from their regard for their own self-interest. We address ourselves not to their humanity, but to their self-love, and never talk to them of our own necessities, but of their advantages.

Smith also argued that a system of competitive markets allocates resources efficiently among the various industries of a society. When the supply of a certain commodity is not enough to meet the demand, buyers bid the price of the commodity upward until it rises above what Smith called the natural price (i.e., the price that just covers the costs of producing the commodity, including the going rate of profit obtainable in other markets). Producers of that commodity then reap profits higher than those available to producers of other commodities. The higher profits induce producers of those other products to switch their resources into the production of the more profitable commodity. As a result, the shortage of that commodity disappears and its price sinks back to its natural level. Conversely, when the supply of a commodity is greater than the quantity demanded, its price falls. This induces its producers to switch their resources into the production of other, more profitable commodities. The fluctuating prices of commodities in a system of competitive markets then forces producers to allocate their resources to those industries where they are most in demand and to withdraw resources from industries where there is a relative. The market, in short, allocates resources so as to most efficiently meet consumer demand, thereby promoting social utility.

The best policy of a government that hopes to advance the public welfare, therefore, is to do nothing: to let each individual pursue self-interest in “natural liberty. Any interventions in the market by government can only serve to interrupt the self-regulating effect of competition and reduce its many beneficial consequences.

Finally, it is important to note that, although Adam Smith did not discuss the notion of private property at great length, it is a key assumption of his views. Before individuals can come together in markets to sell things to each other, they must have some agreement about what each individual "owns" and what each individual has the right to "sell" to others.

Unless a society has a system of private property that allocates its resources to individuals, that society cannot have a free market system. For this reason, Adam Smith assumed that a society with free markets would have a private property system, although he gave no explicit utilitarian arguments showing that a system of private property was better than, say, a system where all productive resources were "owned" in common by everyone. Earlier philosophers, however, had provided utilitarian arguments in support of a private property system. In the 13th Century, for example, philosopher Thomas Aquinas argued that society should not use a system in which all things were owned by everyone "in common." Instead, society would prosper only if its resources were owned by individuals who would then take an interest in improving and caring for those resources.

3.3.1 Criticisms of Adam Smith

Critics of Smith's classic utilitarian argument in defense of free markets and private property have attacked it on a variety of fronts. The most common criticism is that the argument rests on unrealistic assumptions. Smith's arguments assume, first, that the impersonal forces of supply and demand will force prices down to their lowest levels because, the sellers of products are so numerous and each enterprise is so small that no one seller can control the price of a product. This assumption was perhaps true enough in Smith's day, when the largest firms employed only a few dozen men and a multitude of small shops and petty merchants competed for the consumer's attention.

However, today many industries and markets are completely or partially monopolised, and the small firm is no longer the rule. In these monopolised industries, where one or a few large enterprises are able to set their own prices, it is no longer true that prices necessarily move to their lowest levels. The monopoly power of the industrial giants enables them to keep prices at artificially high levels and production at artificially low levels.

Second, critics claim, Smith's arguments assume that all the resources used to produce a product will be paid for by the manufacturer and that the manufacturer will try to reduce these costs to maximise profits. As a result, there is a tendency toward a more efficient utilisation of society's

resources. This assumption is also proved false, when manufacturers of a product consume resources for which they do not have to pay and on which they, therefore, do not try to economise. For example, when manufacturers use up clean air by polluting it, or when they impose health costs by dumping harmful chemicals into rivers, lakes, and seas, they are using resources of society for which they do not pay.

Consequently, there is no reason for them to attempt to minimise these costs, and social waste is the result. Such waste is a particular instance of a more general problem that Smith’s analysis ignored. Smith failed to take into account the external effects that business activities often have on their surrounding environment. Pollution is one example of such effects, but there are others, such as the effects on society of introducing advanced technology, the psychological effects increased mechanisation has had on labourers, the harmful effects that handling dangerous products has on the health of workers, and the economic shocks that result when natural resources are depleted for short-term gains. Smith ignored these external effects of the firm and assumed that the firm is a self-contained agent whose activities affect only itself and its buyers.

Third, critics claim, Smith's analysis wrongly assumes that every human being is motivated only by a “natural” and self-interested desire for profit. Smith, at least in The Wealth of Nations, assumes that in all dealings a person “intends only his own gain.” Human nature follows the rule of “economic rationality”: Give away as little as you can in return for as much as you can get. Because a human being “intends only his own gain” anyway, the best economic arrangement is one that recognizes this “natural” motivation and allows it free play in competitive markets that force self-interest to serve the public interest. However, this theory of human nature, critics have claimed, is clearly false.

First, human beings regularly show a concern for the good of others and constrain their self-interest for the sake of the rights of others. Even when buying and selling in markets, the constraints of honesty and fairness affect our conduct.

Second, the critics claim, it is not necessarily “rational” to follow the rule “give away as little as you can for as much as you can get.” In numerous situations, everyone is better off when everyone shows concern for others, and it is then rational to show such concern.

Third, critics have argued, if human beings often behave like “rational economic men,” this is not because such behaviour is natural, but because the widespread adoption of competitive market relations forces humans to relate to each other as "rational economic men." The market

system of a society makes humans selfish, and this widespread selfishness then makes us think the profit motive .is "natural." It is the institutions of capitalism that engender selfishness, materialism, and competitiveness. In actual fact, human beings are born with a natural tendency to show concern for other members of their species (e.g., in their families). A major moral defect of a society built around competitive markets, in fact, is that within such societies this natural benevolent tendency toward virtue is gradually replaced by self-interested tendencies toward vice. In short, such societies are morally defective because they encourage morally bad character.

As for the argument of Von Mises and Hayek-that human planners cannot allocate resources efficiently-the examples of the French, Dutch, and Swedes have demonstrated that planning within some sectors of the economy is not quite as impossible as Von Mises and Hayek imagined. Moreover, the argument of Von Mises and Hayek was answered on theoretical grounds by the socialist economist Oskar Lange, who demonstrated that a "central planning board" could efficiently allocate goods in an economy without having to know everything about consumers and producers and without engaging in impossibly elaborate calculations. All that is necessary is for the central planners to receive reports on the sizes of the inventories of producer's and price their commodities accordingly. Surplus inventories would indicate that lowering of prices was necessary, whereas inventory shortages would indicate that prices should be raised. By setting the prices of all commodities in this way, the central planning board could create an efficient flow of resources throughout the economy. It must be acknowledged, however, that the kind of large-scale planning that has been attempted in some communist nations-particularly the former Soviet Union-has resulted in large-scale failure. Planning is possible so long as it remains but one component within an economy in which exchanges are for the most part based on market forces.

3.3.2 The Keynesian Criticism

The most influential criticism of Adam Smith's classical assumptions came from John Maynard Keynes (1883-1946), an English economist. Smith assumed that without any help from the government, the automatic play of market forces would ensure full employment of all economic resources including labour. If some resources are not being used, then their costs drop and entrepreneurs are induced to expand their output by using these cheapened resources.

The purchase of these resources in turn, creates the incomes that enable people to buy the products made from them. Thus, all available resources are used and demand always expands to absorb the supply of

commodities made from them (a relationship that is now called Say's Law). Since Keynes, however, economists have argued that, without government intervention, the demand goods may not be high enough to absorb the supply. The result is unemployment and a slide into economic depression.

Keynes argued that the total demand for goods and services is the sum of the demand of three sectors of the economy: households, businesses, and government. The aggregate demand of these three sectors may be less than the aggregate mounts of goods and services supplied by the economy at the full employment level, [his mismatch between aggregate demand and aggregate supply, will occur when households prefer to save some of their income in liquid securities instead of spending it on goods and services.

When, as a consequence, aggregate demand is less than aggregate supply, the result is a contraction of supply. Businesses realise they are not selling all their goods, so they cut back on production and thereby cut back on employment. As production falls, the incomes of households also fall, but the amounts households are willing to save fall even faster. Eventually, the economy reaches a stable point of equilibrium at which demand once again equals supply, but at which there is widespread unemployment of labour and other resources.

Government, according to Keynes, can influence the propensity to save, which lowers aggregate demand and creates unemployment. Government can prevent excess savings through its influence on interest rates, and it can influence interest rates by regulating the money supply: The higher the supply of money, the lower the rates at which it is lent. Second, government can directly affect the amount of money house-holds have available to them by raising or lowering taxes. Third, government spending can close any gap between aggregate demand and aggregate supply by taking up the slack in demand from households and businesses (and, incidentally, creating inflation).

Thus, contrary to Smith's claims, government intervention in the economy is a necessary instrument for maximising society's utility. Free markets alone are not necessarily the most efficient means for coordinating the use of society's resources. Government spending and fiscal policies can serve to create the demand needed to stave off unemployment. These views were the kernels of Keynesian economics.

Keynes's views, however, have fallen on hard times. During the 1970s, the United States (and other Western economies) was confronted with the simultaneous occurrence of inflation and unemployment, termed stagflation. The standard Keynesian analysis would have led us to

believe that these two should not have occurred together: Increased government spending, although inflationary, should have enlarged demand and thereby alleviated unemployment. However, during the 1970s, the standard Keynesian remedy for unemployment (increased government spending) had the expected effect of creating increasing inflation but did not cure unemployment.

Various diagnoses have been offered for the apparent failure of Keynesian economics to deal with the twin problems of inflation and stubborn unemployment particularly during the 1970s. Notable among these are the new Keynesian approaches being pioneered by the so-called post-Keynesian school. John Hicks, a long-time Keynesian enthusiast and a "post-Keynesian," has suggested, for example, that in many industries today prices and wages are no longer determined by competitive market forces as Keynes assumed. Instead, they are set by conventional agreements among producers and unions.

The ultimate effect of these price-setting conventions is continuing inflation in the face of continued unemployment. Regardless of whether Hicks's analysis is correct, a flourishing post-Keynesian school has lately been developing new approaches to Keynes that can more adequately account for the problems of stagflation. Post-Keynesian theories, like those of Hicks, retain the key claim of Keynes; that unemployment can be cured by increasing aggregate demand (the "principle of effective demand"), through government expenditures. Unlike Keynes, however, Hicks and other post-Keynesians take more seriously the oligopolistic nature of most modern industries and unionised labour markets, as well as the role that social conventions and agreements play in these oligopolistic markets as large unions and large companies struggle over income shares. The role for government, then, is even larger than that envisioned by Keynes. Not only must government boost aggregate demand through increased spending, it must also curb the power of large oligopolistic groups.

3.3.3 The Utility of Survival of the Fittest: Social Darwinism

Nineteenth-century social Darwinists added a new twist to utilitarian justifications of free markets by arguing that free markets have beneficial consequences over and above those that Adam Smith identified. They argued that economic competition produces human progress.

The doctrines of social Darwinism were named after Charles Darwin (1809-1882), who argued that the various species of living things were evolving as the result of the action of an environment that favoured the survival of some things while destroying others: "This preservation of

favourable individual differences and variations, and the destruction of those which are injurious, I have called natural selection or the survival of the fittest." The environmental factors that resulted in the survival of the fittest were the competitive pressures of the animal world. As a result of this competitive "struggle for existence," Darwin held, species gradually change because only the "fittest" survive to pass their favorable characteristics on to their progeny.

Even before Darwin published his theories, philosopher Herbert Spencer (1820-1903) and other thinkers had already begun to suggest that the evolutionary processes that Darwin described were also operative in human societies. Spencer claimed that just as competition in the animal world ensures that only the fittest survive, so free competition in the economic world ensures that only the most capable individuals survive and rise to the top.

The implication is that Inconvenience, suffering, and death are the penalties attached by nature to ignorance as well as to incompetence and are also the means of remedying these. Partly by weeding out those of lowest development, and partly by subjecting those who remain to the never-ceasing discipline of experience, nature secures the growth of a race who shall both understand the conditions of existence, and be able to act up to them.

Those individuals whose aggressive business dealings enable them to succeed in the competitive world of business are the "fittest" and therefore the best. Just as survival of the fittest ensures the continuing progress and improvement of an animal species, so the free competition that enriches some individuals and reduces others to poverty, result in the gradual improvement of the human race. Government must not be allowed to interfere with this stern competition because this would only impede progress. In particular, government must not lend economic aid to those who fall behind in the competition for survival. If these economic misfits survive, they will pass on their inferior qualities and the human race will decline.

It was easy enough for later thinkers to revise Spencer's views so as to rid them of their apparent callousness. Modern versions of Spencerism hold that Competition is good not because it destroys the weak individual but because it weeds out the weak firm. Economic competition ensures that the "best" business firms survive and, as a result, the economic system gradually improves. The lesson of modern social Darwinism is the same: Government must stay out of the market because competition is beneficial.

The shortcomings of Spencer's views were obvious even to his contemporaries Critics were quick to point out that the skills and traits that help individuals and firms advance and "survive" in the business world are not necessarily those that help humanity survive on the planet. Advancement in the business world might be achieved through a ruthless disregard for other human beings. The survival of humanity, however, may well depend on the development of cooperative attitudes and the mutual willingness of people to help each other.

The basic problem underlying the views of the social Darwinist, however, is the fundamental normative assumption that survival of the fittest means survival of the best. That is, whatever results from the workings of nature is necessarily good. The fallacy, which modem authors call the naturalistic fallacy, implies, of course, that whatever happens naturally is always for the best. It is a basic failure of logic, however, to infer that what should be or that what nature creates is necessarily for the best.

SELF ASSESSMENT EXERCISE

1. Explain the justification of free trade and utility according to Adam Smith
2. Explain the “utility of survival of the fittest”?

4.0 CONCLUSION

The debate on free markets, free trade, and private property still rages on. In fact, the debate has been spurred on by recent world events, particularly the collapse of several communist regimes, such as the former Soviet Union, and the emergence of strong competitors in several Asian nations, such as China, Japan, Singapore, and Taiwan. Some people have claimed that the collapse of communist regimes around the world has shown that capitalism, with its emphasis on free markets, is the clear winner.

Other observers, however, have held that the emergence of strong economies in nations, that emphasise government intervention and collectivist property rights, such as Japan and Singapore, shows that free markets alone are not the key to prosperity. It is inevitable perhaps; that the controversy has led many economists to advocate retention of market systems and private ownership but modification of their workings through government regulation, so as to rid them of their most obvious defects. The resulting amalgam of government regulations, partially free markets, and limited property rights is appropriately referred to as the mixed economy.

5.0 SUMMARY

Basically, a mixed economy retains a market and private property system but relies heavily on government policies to remedy their deficiencies. Government transfers (of private income) are used to get rid of the worst aspects of inequality by drawing money from the wealthy in the form of income taxes and distributing it to the disadvantaged in the form of welfare. Minimum wage laws, safety laws, union laws, and other forms of labour legislation are used to protect workers from exploitation. Monopolies are regulated, nationalised, or outlawed. Government monetary and fiscal policies attempt to ensure full employment. Government regulatory agencies police firms to ensure they do not engage in socially harmful behaviour.

6.0 TUTOR-MARKED ASSIGNMENT

Explain the justification of free market according to the proponents of free market economy.

7.0 REFERENCES/FURTHER READING

Manuel G. Velasquez: *Business Ethics Concepts and Cases.*

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UNIT 3 BUSINESS SYSTEM II

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1.0 INTRODUCTION

Competition exists in political elections, in football games, on the battlefield, and in courses in which grades are distributed on the curve. Market competition, however, involves more than mere rivalry between two or more firms. This unit examines three models describing three degrees of competition in a market: perfect competition, pure monopoly,

and oligopoly. We will also look at consumer protection, consumer privacy, consumerism and the ethics involved in advertising.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- identify what conditions must be in place for a perfect competitive market to exist
- define the terms: monopoly, oligopoly ,monopoly market and explain why such markets are ethically questionable
- identify how far manufacturers must go to make their products safe
- analyse the relationship between a business and its customers;
- explain the fact that companies usually know more about their products than their customers and the resultant effect on their duty to protect customers from injury or harm
- explain how advertising helps or harms customers
- describe how companies protect their customers' privacy.

3.0 MAIN CONTENT

3.1 Ethics in the Market place

This unit is all about the various types of competitions that exist in the market place and their related ethical issues. Such competitions are perfect, monopoly and oligopolistic competition.

3.2 The Perfect Competition

A market is any forum in which people come together for the purpose of exchanging ownership of goods or money. Markets can be small and very temporary (two friends trading clothes can constitute a tiny transient market) or quite large and relatively permanent (the oil market spans several continents and has been operating for decades).

A perfectly competitive free market is one in which no buyer or seller has the power to significantly affect the prices at which goods are being exchanged. Perfectly competitive free markets are characterised by the following seven features.

- There are numerous buyers and sellers, none of whom has a substantial share of the market.
- All buyers and sellers can freely and immediately enter or leave the market.

- Every buyer and seller has full and perfect knowledge of what every other buyer and seller is doing, including knowledge of the prices, quantities, and quality of all goods being bought and sold.
- The goods being sold in the market are so similar to each other that no one cares from whom each buys or sells.
- The costs and benefits of producing or using the goods being exchanged are borne entirely by those buying or selling the goods and not by any other external parties.
- All buyers and sellers are utility maximisers: Each tries to get as much as possible for as little as possible.
- No external parties (such as the government) regulate the price, quantity or quality of any of the goods being bought and sold in the market.

The first two features are the basic characteristics of a "competitive" market because they ensure that buyers and sellers are roughly equal in power and none can force the others to accept its terms. The seventh feature is what makes a market qualify as a "free" market: It is one that is free of any externally imposed regulations on price, quantity, or quality. (So-called free markets, however, are not necessarily free of all constraints, as we see later.) Note that the term free enterprise is sometimes used to refer to perfectly competitive free markets.

In addition to these seven characteristics, free competitive markets also need an enforceable private property system (otherwise, buyers and sellers would not have any ownership rights to exchange), an underlying system of contracts (which allows buyers and sellers to forge agreements that transfer ownership), and an underlying system of production (that generates goods or services whose ownership can be exchanged).

In a perfectly competitive free market, the buyers are willing to pay for goods at higher prices when fewer goods are available, and these rising prices induce sellers to provide greater quantities of goods. Thus, as more goods are made available, prices tend to fall, and these falling prices lead sellers to decrease the quantities of goods they provide. These fluctuations produce a striking outcome: In a perfectly competitive market, prices and quantities always move toward what is called the equilibrium point. The equilibrium point is the point at which the amount of goods buyers want to buy exactly equals the amount of goods sellers want to sell and at which the highest price buyers are willing to pay equals exactly the lowest price sellers are willing to take. At the equilibrium point, every seller finds a willing buyer and every buyer finds a willing seller.

Moreover, this surprising result of perfectly competitive free markets has an even more astonishing outcome: It satisfies three of the moral criteria-justice, utility, and rights. That is, perfectly competitive free markets achieve a certain kind of justice, they satisfy a certain version of utilitarianism, and they respect certain kinds of moral rights.

Why do perfectly competitive markets achieve these three surprising moral outcomes? The well-known supply and demand curves can be used to explain the phenomenon. Our explanation proceeds in two stages. First, we see why perfectly competitive free markets always move toward the equilibrium point. Then we see why markets that move toward equilibrium in this way achieve these three moral outcomes.

3.2.1 Equilibrium in Perfectly Competitive Markets

A demand curve is a line on a graph indicating the most that consumers (or buyers) would be willing to pay for a unit of some products when they buy different quantities of those products. As we mentioned, the fewer the units of a certain product consumers buy, the more they are willing to pay for those units, so the demand curve slopes down to the right.

Notice that the demand curve slopes downward to the right, indicating that consumers are willing to pay less for each unit of a good as they buy more of those units; the value of a potato falls for consumers as they buy up more potatoes. Why is this? This phenomenon is explained by a principle we assume that human nature always follows-the so-called principle of diminishing marginal utility. This principle states that each additional item a person consumes is less satisfying than each of the earlier items the person consumed.

Now, let us look at the other side of the market: the supply side. A supply curve is a line on a graph indicating the prices producers must charge to cover the average costs of supplying a given amount of a commodity. Beyond a certain point (which we explain shortly), the more units producers make, the higher the average costs of making each unit, so the curve slopes upward to the right.

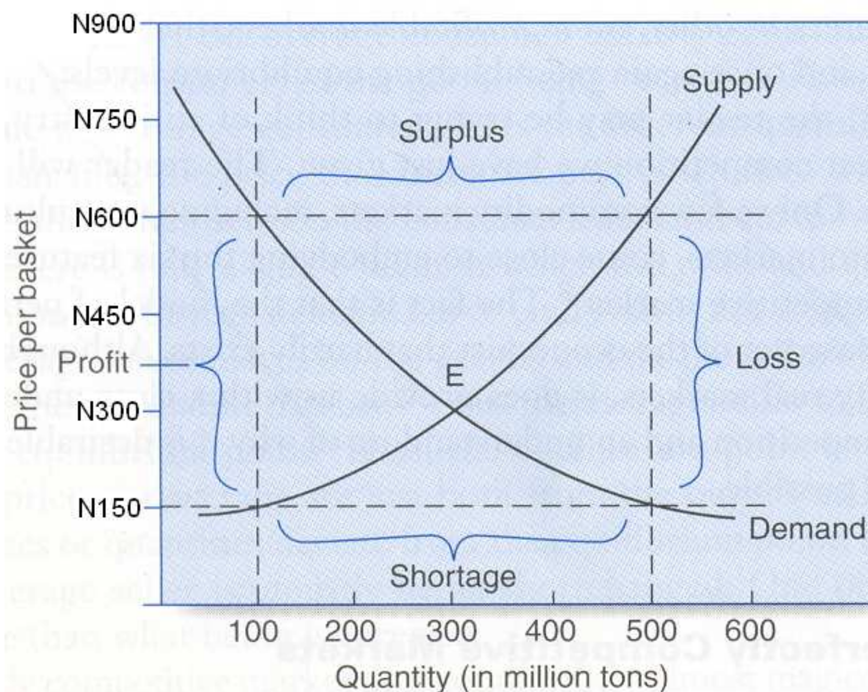

Fig. 1: Equilibrium in the perfectly competitive market

At first sight, it may seem odd that producers or sellers must charge higher prices when they are producing large volumes than when producing smaller quantities. We are accustomed to thinking that it costs less to produce goods in large quantities than in small quantities. However, the increasing costs of production are explained by a principle that we call the principle of increasing marginal costs.

This principle states that, after a certain point, each additional item the seller produces costs more to produce than earlier items. Why? Because of an unfortunate feature of our physical world: Its productive resources are limited. A producer will use the best and most productive resources to make the first few goods and at this point costs will indeed decline as production expands. A potato grower farming in a valley, for example, will begin by planting the level fertile acres in the floor of the valley where the more acreage planted the more the costs per unit decline. But as the farm continues to expand, the farmer eventually runs out of these highly productive resources and must turn to using less productive land.

As the acreage on the floor of the valley is used up, the farmer is forced to start planting the sloping and less fertile land at the edges of the valley, which may be rocky and may require more expensive irrigation. If production continues to increase, the farmer will eventually have to start planting the land on the mountainsides and costs will rise even higher. Eventually, the farmer reaches a situation where the more that is produced the more it costs to produce each unit because the farmer is forced to use increasingly unproductive materials.

The predicament of the potato farmer illustrates the principle of increasing marginal costs: After a certain point, added production always entails increasing costs per unit. That is the situation illustrated by the supply curve. The supply curve rises upward to the right because it pictures the point at which sellers must begin to charge more per unit to cover the costs of supplying additional goods.

Sellers and buyers, of course, trade in the same markets, so their respective supply and demand curves can be superimposed on the same graph. Typically when this is done, the supply and demand curves will meet and cross at some point. The point at which they meet is the point at which the price buyers are willing to pay for a certain amount of goods exactly matches the price sellers must take to cover the costs of producing that same amount (i.e., the "equilibrium price"). This point of intersection, as indicated in Figure 1 where the point E at which the supply and demand curve meet, is the so-called point of equilibrium or equilibrium price. It is at N300 on the graph.

We mentioned that in a perfectly competitive free market, prices, the amounts supplied, and the amounts demanded all tend to move toward the point of equilibrium. Why does this happen? Notice in Figure 1 that if the prices of potatoes rise above the point of equilibrium, say to N600 per basket, producers will supply more goods (500 million tons) than at the equilibrium price level (450 million tons). But at that high price, consumers will purchase fewer goods (only 100 million tons) than at the equilibrium price. The result will be a surplus of unsold goods (500 - 100 = 400 million tons of unsold potatoes). To get rid of their unsold surplus, sellers will be forced to lower their prices and decrease production. Eventually, equilibrium prices and amounts will be reached.

In contrast, if the price drops below the point of equilibrium in Figure 1, say to N150 per basket, then producers will start losing money and so will supply less than consumers want at that price. The result will be an excessive demand and shortages will appear. The shortages will lead buyers to bid up the price. Subsequently, prices will rise and the rising prices will attract more producers into the market, thereby raising supplies. Eventually, again, equilibrium will reassert itself.

3.2.2 Ethics and Perfect Competitive Markets

As we have seen, perfectly competitive free markets incorporate forces that inevitably drive buyers and sellers toward the so-called utility of buyers and sellers by leading them to allocate, use, and distribute point of equilibrium. In doing so, they achieve three major moral values.

- They lead buyers and sellers to exchange their goods in a way that is just (in a certain sense of just);
- They maximise their goods with perfect efficiency; and
- They bring about these achievements in a way that respects buyers' and sellers' right of free consent. As we examine each of these moral achievements, it is important to keep in mind that they are characteristics only of the perfectly competitive free market-that is, of markets that have the seven features we listed. Markets that fail to have one or the other of these features do not necessarily achieve these three moral values.

To understand why perfectly competitive free markets lead buyers and sellers to make exchanges that are just, we begin by recalling the capitalist meaning of justice described in Unit 5. According to the capitalist criterion of justice, benefits and burdens are distributed justly when individuals receive in return at least the value of the contribution they made to an enterprise: Fairness is getting paid fully in return for what one contributes. It is this form of justice (and only this form) that is achieved in perfectly competitive free markets.

Perfectly competitive free markets embody capitalist justice because such markets necessarily converge on the equilibrium point, and the equilibrium point is the one (and only) point at which buyers and sellers on average receive the value of what they contribute. Why is this true? Consider the matter, first, from the seller's point of view. The supply curve indicates the price producers must receive to cover what it costs them to produce given quantities of a good. Consequently, if prices (and quantities) fall below the seller's supply curve, consumers are unfairly shortchanging the seller because they are paying less than the seller contributed to produce those goods in those quantities.

If prices rise above the seller's supply curve, the average seller is unfairly overcharging consumers because they are being charged more than what the seller knows those goods are worth in terms of what it costs to produce them. Thus, from the standpoint of the seller's contribution, the price is fair (i.e., the price equals the costs of the seller's contribution) only if it falls somewhere on the seller's supply curve.

Next, consider the matter from the standpoint of the average buyer. The demand curve indicates the highest price consumers are willing to pay for given quantities of goods. So if the prices (and quantities) of goods were to rise above the consumer's demand curve, the average consumer would be contributing more for those goods than what the goods (in those quantities) are worth. If prices (and quantities) fall below the consumer's demand curve, the average consumer unfairly contributes

less to sellers than the value (to the consumer) of the goods being received. Thus, from the standpoint of the value the average consumer places on different quantities of goods, the contribution is fair (i.e., the price the consumer pays is equal to what the goods are worth) only if it falls somewhere on the consumer's demand curve.

Obviously, there is only a single point at which the price and quantity of a commodity lies both on the buyer's demand curve (and is thus fair from the standpoint of the value the average buyer places on the goods) and on the seller's supply curve (and is thus fair from the standpoint of what it costs the average seller to bring those goods to market): the equilibrium point. Thus, the equilibrium point is the one and only point at which prices on average are just both from the buyer's and seller's points of view. When prices or quantities deviate from the equilibrium point, either the average buyer or the average seller is unjustly being shortchanged: One or the other has to contribute more than what is being received.

The perfectly competitive market thus continually, almost magically, reestablishes capitalist justice for its participants by continually leading them to buy and sell goods at the one quantity and the one price at which each receives the value of what is contributed, whether this value is calculated from the average buyer's or the average seller's point of view.

In addition to establishing a form of justice, competitive markets also maximise the utility of buyers and sellers by leading them to allocate, use, and distribute their goods with perfect efficiency. To understand this aspect of perfectly competitive markets, we must consider what happens not in a single isolated market, but in an economy that consists of a system of many markets. A market system is perfectly efficient when all goods in all markets are allocated, used, and distributed in a way that produces the highest level of satisfaction possible from these goods. A system of perfectly competitive markets achieves such efficiency in three main ways.

First, a perfectly competitive market system motivates firms to invest resources in those industries where consumer demand is high and to move resources away from industries where consumer demand is low. Resources will, be attracted into markets where high consumer demand creates shortages that raise prices above equilibrium, and they will flee markets where low consumer demand leads to surpluses that lower prices below equilibrium. The perfectly competitive market system allocates resources efficiently in accordance with consumer demands and needs; the consumer is “sovereign” over the market.

Second, perfectly competitive markets encourage firms to minimise the amount of resources consumed in producing a commodity and use the most efficient technology available. Firms are motivated to use resources sparingly because they want to lower their costs and thereby increase their profit margin. Moreover, to not lose buyers to other firms, each firm will reduce its profits to the lowest levels consistent with the survival of the firm. The perfectly competitive market encourages an efficient use of the seller’s resources as well.

Third, perfectly competitive markets distribute commodities among buyers in such a way that all buyers receive the most satisfying bundle of commodities they can purchase, given the commodities available to them and the money they can spend on these commodities. When faced by a system of perfectly competitive markets, each buyer will buy up those proportions of each commodity that correspond with the buyer's desire for the commodity when weighed against the buyer’s desires for other commodities. When buyers have completed their buying, they will know that they cannot improve on their purchases by trading their goods with other consumers because all consumers can buy the same goods at the same prices. Thus, perfectly competitive markets enable consumers to attain a level of satisfaction on which they cannot improve given the constraints of their budgets and the range of available goods. An efficient distribution of commodities is thereby achieved.

Finally, perfectly competitive markets establish capitalist justice and maximise utility in a way that respects buyers' and sellers' negative rights.

First, in a perfectly competitive market, buyers and sellers are free (by definition) to enter or leave the market as they choose. That is, individuals are neither forced into nor prevented from engaging in a certain business, provided they have the expertise and the financial resources required. Perfectly competitive markets thus embody the negative right of freedom of opportunity.

Second, in the perfectly competitive free market, all exchanges are fully voluntary. That is, participants are not forced to buy or sell anything other than what they freely and knowingly consent to buy or sell. In a competitive free market, all participants have full and complete knowledge of what they are buying or selling, and no external agency (such as the government) forces them to buy or sell goods they do not want at prices they do not choose in quantities they do not desire. Moreover, buyers and sellers in a perfectly competitive free market are not forced to pay for goods that others enjoy. In a perfectly competitive free market, by definition, the costs and benefits of producing or using

goods are borne entirely by those buying or selling the goods and not by any other external parties. Free competitive markets thus embody the negative right of freedom of consent.

Third, no single seller or buyer will so dominate the perfectly competitive free market that others are forced to accept the terms or go without. In a perfectly competitive market, industrial power is decentralised among numerous firms so that prices and quantities are not dependent on the whim of one or a few businesses. In short, perfectly competitive free markets embody the negative right of freedom from coercion.

Thus, perfectly competitive free markets are perfectly moral in three important respects:

- Each continuously establishes a capitalist form of justice;
- Together they maximise utility in the form of market efficiency; and
- Each respects certain important negative rights of buyers and sellers.

3.3 Monopoly Competition

What happens when a free market (i.e., one without government intervention) ceases to be perfectly competitive? We begin to answer this question in this section by examining the opposite extreme of a perfectly competitive market: the free (unregulated) monopoly market. We then examine some less extreme varieties of non-competition.

We noted earlier that a perfectly competitive market is characterised by seven conditions. In a monopoly, two of these conditions are not present. First, instead of “numerous sellers, none of whom has a substantial share of the market,” the monopoly market has only one seller, and that single seller has a substantial (100 percent) share of the market. Second, instead of being a market that other sellers “can freely and immediately enter or leave,” the monopoly market is one that other sellers cannot enter. Instead, there are “barriers to entry” such as patent laws, which give only one seller the right to produce a commodity, or high entry costs, which make it too expensive for a new seller to start a business in that industry.

Monopolies can also be created through mergers. At the end of the 19th Century, for example, the leading oil refineries merged into a "holding company" (then called Standard Oil, now named Exxon), which acquired monopoly control over oil refining. The monopoly was broken into 34 separate companies when the Supreme Court charged the

company with monopolisation in 1911. A policy of forced mergers during the closing decades of the 19th century enabled the American Tobacco Company to absorb all the major cigarette manufacturing companies in the United States so that by the turn of the century, the combine controlled the American cigarette market. In 1911, the company was ordered to break up into several smaller firms.

Monopoly markets, then, are those in which a single firm is the only seller in the market and which new sellers are barred from entering. A seller in a monopoly market, therefore, can control the prices of the available goods. Figure2 illustrates the situation in a monopoly market: The monopoly firm is able to fix its output at a quantity that is less than equilibrium and at which demand is so high that it allows the firm to reap an excess monopoly profit by charging prices that are far above the supply curve and above the equilibrium price. A monopoly seller, for example, can set prices above their equilibrium level-at, say, N450. By limiting supply to only those amounts buyers will purchase at the monopolist's high prices (300 units), the monopoly firm can ensure that it sells all its products and reaps substantial profits from its business. The monopoly firm will, of course, calculate the price-amount ratios that will secure the highest total profits (i.e., the profit-per-unit multiplied by the number of units), and it can then fix its prices and production volume at those levels. At the turn of the century, for example, the American Tobacco Company, which earlier had managed to acquire a monopoly in the sale of cigarettes, was making profits equal to about 56 percent of its sales.

Conclusively, pure monopoly is a situation whereby one firm provides a certain product or service in a particular country or area e.g., Power Holding Company of Nigeria. Note that an unregulated monopolist might charge a high price, do little or no advertising, and offer minimal service. If partial substitutes are available and there is some danger of competition, the monopolist might invest in more service and technology. A regulated monopolist is required to charge a lower price and provide more service as a matter of public interest.

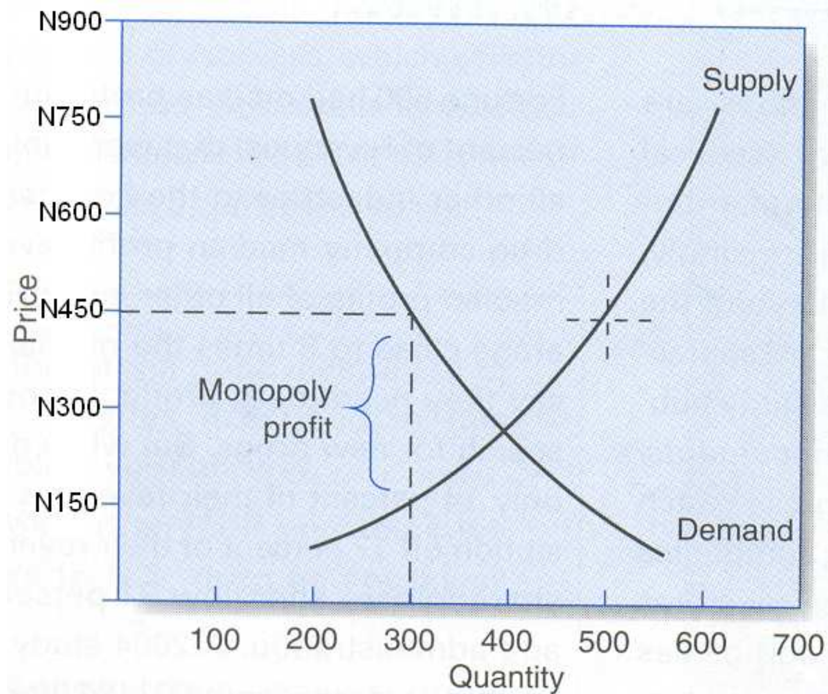

Fig. 2: Illustrating monopolistic competition

3.3.1 Monopoly Competition: Justice, Utility, and Rights

How well does a free monopoly market succeed in achieving the moral values that characterise perfectly competitive free markets? Not well. Unregulated monopoly markets can fall short of the three values of capitalist justice, economic efficiency, and respect for negative rights that perfect competition achieves.

The most obvious failure of monopoly markets lies in the high prices they enable the monopolist to charge and the high profits they enable the monopolist to reap-a failure that violates capitalist justice. Why do the high prices and profits of the monopolist violate capitalist justice? Capitalist justice says that what each person receives should equal the value of the contribution made. As we saw, the equilibrium point is the one (and only) point at which buyers and sellers each receive in return the exact value of what each contributes to the other, whether this value is determined from the average buyer's or the average seller's point of view. In a monopoly market, however, prices for goods are set above the equilibrium level, and quantities are set at less than the equilibrium amount. As a result, the seller charges the buyer far more than the goods are worth (from the average seller's point of view) because charges are far more than the costs of making those goods. Thus, the high prices the seller forces the buyer to pay are unjust, and these unjustly high prices are the source of the seller's excess profits.

A monopoly market also results in a decline in the efficiency with which it allocates and distributes goods. First, the monopoly market allows resources to be used in ways that will produce shortages of those things buyers want and cause them to be sold at higher prices than necessary. The high profits in a monopoly market indicate a shortage of goods. However, because other firms are blocked from entering the market, their resources cannot be used to make up the shortages indicated by the high profits. This means that the resources of these other firms are deflected into other non-monopoly markets that already have an adequate supply of goods. Shortages, therefore, continue to exist.

Moreover, the monopoly market allows the monopoly firm to set its prices well above costs, instead of forcing the firm to lower its prices to cost levels. The result is an inflated price for the consumer-a price that the consumer is forced to accept because the absence of other sellers has limited the choices. These excess profits absorbed by the monopolist are resources that are not needed to supply the amounts of goods the consumer is getting.

Second, monopoly markets do not encourage suppliers to use resources in ways that will minimise the resources consumed to produce a certain amount of a commodity. A monopoly firm is not encouraged to reduce its costs and is therefore not motivated to find less costly methods of production. Because profits are high anyway, there is little incentive for it to develop new technology that might reduce costs or that might give it a competitive edge over other firms, for there are no other competing firms.

Third, a monopoly market allows the seller to introduce price differentials that block consumers from putting together the most satisfying bundle of commodities they can purchase given the commodities available and the money they can spend. Because everyone must buy from the monopoly firm, the firm can set its prices so that some buyers are forced to pay a higher price for the same goods than others. For example, the monopoly firm can adjust its prices so that those consumers who have a greater desire for its goods must pay a higher price for the same goods than those consumers who have a lesser desire for them. As a consequence, those who have the greater desire now buy less and those who have the lesser desire now buy more than either would buy at an equal price. The result is that, some consumers are no longer able to purchase the most satisfying bundle of goods they could buy.

Monopoly markets also embody restrictions on the negative rights that perfectly free markets respect. First, monopoly markets by definition are markets that other sellers are not free to enter. Second, monopoly

markets enable the monopoly firm to force on its buyers goods that they may not want in quantities they may not desire. The monopoly firm, for example, can force consumers to purchase product X only if they also purchase product Y from the firm. Third, monopoly markets are dominated by a single seller whose decisions determine the prices and quantities of a commodity offered for sale. The monopoly firm's power over the market is absolute.

A monopoly market, then, is one that deviates from the ideals of capitalist justice, economic utility, and negative rights. Instead of continually establishing a just equilibrium, the monopoly market imposes unjustly high prices on the buyer and generates unjustly high profits for the seller. Instead of maximising efficiency, monopoly markets provide incentives for waste, misallocation of resources, and profit-gouging. Instead of respecting negative rights of freedom, monopoly markets create an inequality of power that allows the monopoly firm to dictate terms to the consumer. The producer then replaces the consumer as “sovereign” of the market.

3.4 Oligopolistic Competition

Few industries are monopolies. Most major industrial markets are not dominated by a single firm, but more usually by as many as four firms or more. Such markets lie somewhere on the spectrum between the two extremes of the perfectly competitive market with innumerable sellers and the pure monopoly market with only one seller. Market structures of this "impure" type are referred to collectively as imperfectly competitive markets, of which the most important kind is the oligopoly.

In an oligopoly, two of the seven conditions that characterise the purely competitive market are once again not present. First, instead of many sellers, there are only a few significant sellers. That is, most of the market is shared by a relatively small number of large firms that together can exercise some influence on prices. The share each firm holds may be somewhere between 25 percent and 90 percent of the market, and the firms controlling this share may range from 2 to 50 depending on the industry. Second, other sellers are not able to freely enter the market. Although more than one seller is present in an oligopoly market, new sellers find it difficult to break into the industry. This may be because of the prohibitively high costs of starting a business in that industry, it may be as a result of long-term contracts that have tied all the buyers to the firms already in the industry, or it may be because of enduring loyalties created by brand-name advertising.

Oligopoly markets, which are dominated by a few (e.g., three to eight) large firms, are said to be highly concentrated. Examples of such

oligopoly markets are not hard to find because they include many of the largest manufacturing industries.

Although oligopolies can form in a variety of ways, the most common causes of an oligopolistic market structure are horizontal mergers. A horizontal merger is simply the unification of two or more companies that were formerly competing in the same line of business. If enough companies in a competitive industry merge, the industry can become an oligopoly composed of a few very large firms.

During the 1950s, for example the 108 competing banks in Philadelphia began to merge until, by 1963, the number of bank firms had been reduced to a smaller number. The Philadelphia National Bank emerged as the second-largest bank (as a result of nine mergers), and the Girard Bank emerged as the third-largest (as a result of six mergers). In the early 1960s, the Philadelphia National Bank and the Girard Bank proposed to merge into a single firm. If the merger had been approved (the government stopped it), the two banks together would have controlled well over one-third of the banking activities of metropolitan Philadelphia.

How do oligopoly industries affect the market? Because a highly concentrated oligopoly has a relatively small number of firms, it is relatively easy for the managers of these firms to join forces and act as a unit. By explicitly or tacitly agreeing to set their prices at the same levels and to restrict their output accordingly, the oligopolists can function much like a single giant firm. This uniting of forces, together with the barriers to entry that are characteristic of oligopoly industries, can result in the same high prices and low supply levels characteristic of monopoly markets. As a consequence, oligopoly markets, like monopolies, can fail to exhibit just profit levels, can generate a decline in social utility, and can fail to respect basic economic freedoms. It has been shown, for example, that generally the more highly concentrated an oligopoly industry is, the higher the profits it is able to extract. Studies also have estimated that the overall decline in consumer utility as a result of inefficient allocation of resources by highly concentrated oligopoly industries ranges between 0.5 percent and 4.0 percent of the nation's gross national product.

3.4.1 Explicit Agreements

Prices in an oligopoly can be set at profitable levels through explicit agreements that restrain competition. The managers of the few firms operating in an oligopoly can meet and jointly agree to fix prices at a level much higher than what each would be forced to take in a perfectly competitive market. The greater the degree of market concentration

present in an industry, the fewer the managers that have to be brought into such a price-fixing agreement, and the easier it is for them to come to an agreement. Such agreements, of course, reproduce the effects of a monopoly and consequently curtail market justice, market efficiency, and market rights as defined in the first section of this unit.

If the justice, freedom, and social utility that competitive markets achieve are important values for society, then it is crucial that the managers of oligopoly firms refrain from engaging in practices that restrict competition. Only if markets function competitively will they exhibit the justice, freedom, and utility that justify their existence. These beneficial aspects of a free market are reaped by society only as long as monopoly firms refrain from engaging in collusive arrangements that do away with competition and reproduce the effects of monopoly markets. In particular, the following sorts of market practices have been identified as unethical.

3.4.1.1 Price-Fixing

When firms operate in an oligopoly market, it is easy enough for their managers to meet secretly and agree to set their prices at artificially high levels. This is straightforward price-fixing. In 2002, for example, the managers of six companies, Hoffmann-La Roche Inc., BASF Corp., Aventis Animal Nutrition S.A, Takeda Chemical Industries Ltd., Eisai Co. Ltd, and Daiichi Pharmaceutical Co. Ltd.-that then controlled over 80 per cent of the world's vitamin market, paid N225 million to settle a suit alleging they had fixed worldwide prices for vitamins. New York Attorney General Eliot Spitzer said, "The companies met in secret, in locations around the world, to carry out illegal agreements that imposed a hidden 'vitamin tax' on shoppers that drove up weekly grocery bills and cost consumers and businesses hundreds of millions of dollars over the past decade”.

3.4.1.2 Manipulation of Supply

Firms in an oligopoly industry might agree to limit their production so that prices rise to levels higher than those that would result from free competition. When hardwood manufacturers met periodically in trade associations early in this century, they would often agree on output policies that would secure high profits. The American Column and Lumber Company were eventually prosecuted under the Sherman Antitrust law to force it to desist from this practice. Such a “manipulation of supply” would also result in market shortages.

3.4.1.3 Exclusive Dealing Arrangements

A firm institutes an exclusive dealing arrangement when it sells to a retailer on condition that the retailer will not purchase any products from other companies and/or will not sell outside of a certain geographical area. During the 1940s, for instance, American Can Company would lease its can-closing machines (at very low prices), only to those customers who agreed not to purchase any cans from Continental Can Company, its major competitor.

Exclusive dealing arrangements tend to remove competition between retailers who are all selling the same company's products, and to this extent they conflict with the values of free competition. However, an exclusive dealing arrangement can also motivate those retailers who are selling the products of a single company to become more aggressive in selling the products of that company. In this way, an exclusive dealing arrangement can actually increase competition between retailers selling the products of different companies. For this reason, exclusive dealing arrangements must be examined carefully to determine whether their overall effect is to dampen or promote competition. In Nigeria, such exclusive arrangement is prominent in the beverage and soft drinks industry, where retailers are provided with kiosks of either that of Coca-cola (market leader) or that of Pepsi, the major competitor and these, retailers are expected to sell only the company's products.

3.4.1.4 Tying Arrangements

A firm enters into a tying arrangement when it sells a buyer a certain good only on condition that the buyer agrees to purchase certain other goods from the firm. Chicken Delight, for example, franchises home delivery and pick-up food stores whose major product is chicken cooked in a special mix. In 1970, Chicken Delight would sell a franchise license to a person only if the person also agreed to purchase a certain number of cookers, fryers, and other supplies. The firm was subsequently forced to stop the practice through legal action.

3.4.1.5 Retail Price Maintenance Agreements

If a manufacturer sells to retailers only on condition that they agree to charge the same set retail prices for its goods, it is engaging in "retail price maintenance." Eastman Kodak Company, for example, until stopped by the Federal Trade Commission, used to establish the prices at which retailers had to sell its Kodachrome and Magazine Cine-Kodak Film and would not sell to retailers unless they agreed to abide by these prices. A manufacturer may publish suggested retail prices and may even refuse to sell to retailers who regularly sell their goods at lower

prices. It is illegal, however, for retailers to enter an agreement to abide by the manufacturer's prices and illegal for manufacturers to force retailers to enter such an agreement. Retail price maintenance dampens competition between retailers and removes from the manufacturer the competitive pressure to lower prices and cut costs.

3.4.1.6 Price Discrimination

To charge different prices to different buyers for identical goods or services is to engage in price discrimination. Price discrimination was used by Continental Pie Company during the 1960s in an attempt to undersell Utah Pie Company, which had managed to take away much of the Salt Lake City business of Continental Baking Company. For several years, Continental sold its pies to Salt Lake City customers at prices substantially lower than those it charged for the same goods sold to customers in other areas. The Supreme Court found such pricing practices “predatory.” Price differences are legitimate only when based on volume differences or other differences related to the true costs of manufacturing, packaging, marketing transporting, or servicing goods.

I think we are particularly vulnerable where we have a salesman with two kids, plenty of financial demands, and a concern over the security of his job. There is a certain amount of looseness to a new set of rules. He may accept questionable practices feeling that he may just not know the system. There are no specific procedures for him to follow other than what other salesmen tell him. At the same time, he is in an industry where the acceptance for his product and the level of profitability are clearly dropping. Finally, we add to his pressures by letting him know who will take his job from him if he doesn't get good price and volume levels. I guess this will bring a lot of soul-searching out of an individual.

3.4.2 Tacit Agreements

Although most of the forms of explicit market agreements enumerated are illegal, the more common types of price-setting in oligopolies are accomplished through some unspoken form of cooperation against which it is difficult to legislate. How does this take place? The managers of the major firms in an oligopoly can learn by hard experience that competition is not in their personal financial interests. Price-cutting competition, they find, will only lead to minimal profits. The firms in an oligopoly, therefore, may each come to the conclusion that cooperation is in the best interests of all. Each firm may then reach the independent conclusion that they will all benefit if, when one major firm raises its prices, all other firms set their prices at the same high levels.

Through this process of "price-setting," all the major firms will retain their share of the market and they will all gain by the higher price. Since the 1930s, for example, the major tobacco companies have charged identical list prices for cigarettes. When one company decides it has a reason to raise or lower its cigarette prices, the other companies will always follow suit within a short period of time. The officials of these companies, however, have made no explicit agreement to act in concert. Without ever having talked the matter over among themselves, each realises that all will benefit, so long as they continue to act in a unified fashion. In 1945, incidentally, the U.S. Supreme Court found the dominant cigarette companies guilty of tacit collusion but the companies; reverted to identical pricing after the case was settled. In Nigeria, anytime Coca-Cola increases its unit price per bottle, Pepsi will also increase theirs.

To co-ordinate their prices, some oligopoly industries will recognise one firm as the industry's "price leader." Each firm will tacitly agree to set its prices at the levels announced by the price leader, knowing that all other firms will also follow its price leadership. Because each oligopolist knows it will not have to compete with another firm's lower prices, it is not forced to reduce its margin of profit to the levels to which open competition would reduce them. There need be no overt collusion involved in this form of price-setting, only an unspoken understanding that all firms will follow the price leadership of the dominant firm and will not engage in the price-lowering tactics of competition.

Whether prices in an oligopoly market are set by explicit agreements or implicit understandings, it is clear that social utility declines to the extent that prices are artificially raised above the levels that would be set by a perfectly competitive market. Consumers must pay the unjust prices of the oligopolists, resources are no longer efficiently allocated and used, and the freedom of both consumers and potential competitors diminishes.

3.4.3 Bribery

When used to secure the sale of a product, political bribery can also introduce diseconomies into the operations of markets. This is a form of market defect that received a great deal of public attention during the late 1970s, when it was discovered that a sizable group of companies had attempted to land contracts with overseas governments by paying bribes to various government officials. Lockheed Aircraft Corporation, for example, paid several million dollars to government officials in Saudi Arabia, Japan, Italy, and Holland to influence aircraft sales in those countries.

When bribes are used to secure the purchase of a commodity, the net effect is a decline in market competition. The product of the briber no longer competes equally with the product of other sellers on the basis of its price or merits. Instead, the bribe serves as a barrier to prevent other sellers from entering the briber's government market. Because of the bribe, the government involved buys only from the firm who supplies the bribe and the briber becomes in effect a monopoly seller.

If a briber succeeds in preventing other sellers from receiving equal entry into a government market, it becomes possible for the briber to engage in the inefficiencies characteristic of monopolies. The bribing firm can impose higher prices, engage in waste, and neglect quality and cost controls because the monopoly secured by the bribe will secure a sizeable profit without the need to make the price or quality of its products competitive with those of other sellers.

Bribes used to secure the sale of products by shutting out other sellers differ, of course, from bribes used for other purposes. An official may insist on being paid to perform legal duties on behalf of a petitioner, as when, for example, a customs officer asks for a "tip" to expedite the processing of an import permit. A government official may offer to lower a costly tariff in return for an under-the-table payment. The previous analysis would not apply to bribes of this sort, which are being used for a purpose other than to erect market barriers.

In determining the ethical nature of payments used for purposes other than to shut out other competitors from a market, the following considerations are relevant.

- Is the offer of a payment initiated by the payer (the one who pays the money), or does the payee (the one who receives the money) demand the payment by threatening injury to the payer’s interests? In the latter case, the payment is not a bribe but a form of extortion. If the threatened injury is large enough, the payer may not be morally responsible for the act, or the moral responsibility may at least be diminished.

- Is the payment made to induce the payee to act in a manner that violates the official sworn duty to act in the best interests of the public? Or is the payment made to induce the payee to perform what is already an official duty? If the payee is being induced to violate official duty, then the payer is cooperating in an immoral act because the payee has entered an agreement to fulfill these duties.

- Are the nature and purpose of the payment considered ethically unobjectionable in the local culture? If a form of payment is a locally accepted public custom and there is a proportionately serious reason for making the payment (it is not intended to erect a market barrier nor to induce an official to violate public duties), then it would appear to be ethically permissible on utilitarian grounds. (It might, however, constitute a legal violation of the Foreign Corrupt Practices Act of 1977.).

3.5 Markets and Consumer Protection

Many people believe that consumers automatically will be protected from injury by the operations of free and competitive markets and that neither governments nor free markets promote an allocation, use, and distribution of goods that are, in a certain sense, just, respectful of rights, and efficiently productive of maximum utility for those who participate in the market. Moreover, in such markets, the consumer is said to be "sovereign." When consumers want and will willingly pay for something, sellers have an incentive to cater for their wishes. If sellers do not provide what consumers want, then sellers will suffer losses. However, when sellers provide what consumers want, they will profit. As the author of a leading textbook on economics wrote, "Consumers direct by their innate or learned tastes, as expressed in their naira votes, the ultimate uses to which society's resources are channeled".

In the "market" approach to consumer protection, consumer safety is seen as a good that is most efficiently provided through the mechanism of the free market whereby sellers must respond to consumer demands. If consumers want products to be safer, they will indicate this preference in markets by willingly paying more for safer products and showing a preference for manufacturers of safe products while turning down the goods of manufacturers of unsafe products. Producers will have to respond to this demand by building more safety into their products or they risk losing customers to competitors who cater to the preferences of consumers. Thus, the market ensures that producers respond adequately to consumers' desires for safety.

However, if consumers do not place a high value on safety and demonstrate neither a willingness to pay more for safety nor a preference for safer products, then it is wrong to push increased levels of safety down their throats through government regulations that force producers to build more safety into their products than consumers demand. Such government interference, as we saw earlier, distorts markets, making them unjust, disrespectful of rights, and inefficient. It is just as wrong for businesspeople to decide on their own that consumers

should have more protection than they are demanding as to force on them costly safety devices that they would not buy on their own. Only consumers can say what value they place on safety, and they should be allowed to register their preferences through their free choices in markets and not be coerced by businesses or governments into paying for safety levels they may not want.

Unfortunately, virtually all consumer choices are based on probability estimates we make concerning the chances that the products we buy will function as we think they will. All the research available shows that we become highly inept, irrational, and inconsistent when we make choices based on probability estimates.

First, as is obvious to any observer, few of us are good at estimating probabilities. We typically underestimate the risks of personal life-threatening activities, such as driving, smoking, or eating fried foods, and of being injured by the products we use, and we overestimate the probabilities of unlikely but memorable events such as tornadoes or attacks by animals at the zoo. Studies have shown that our probability judgments go astray for a number of reasons, including the following:

- Prior probabilities are ignored when new information becomes available, even if the new information is irrelevant.
- Emphasis on "causation" results in the underweighting of evidence that is relevant to probability but is not perceived as "causal.
- Generalisations are made on the basis of small sample findings.
- Belief is placed in a self-correcting but nonexistent "law of averages.
- People believe that they exert control over purely chance events.

Second, as a number of researchers have shown, people are irrational and inconsistent when weighing choices based on probability estimates of future costs or payoffs. For example, one set of researchers found that when people are asked to rank probable payoffs, they inconsistently will rank one payoff as being both better and worse than another. Another investigator found that when people were asked which of two probable payoffs they preferred, they would often say that they would pay more for the payoff that they least preferred. Another set of studies found that, in many cases, a majority of persons would prefer one probable payoff to another in one context but reversed their preferences in a different context although the probable payoffs were identical in both contexts.

Finally, as several critics have pointed out markets often fail to incorporate the most fundamental characteristic of competitive markets: the presence of numerous buyers and sellers. Although buyers or

consumers in most markets are numerous, still many, perhaps most, consumer markets are monopolies or oligopolies; that is, they are dominated by one or a few large sellers. Sellers in monopoly and oligopoly markets are able to extract abnormally high profits from consumers by ensuring that supply is insufficient to meet demand, thereby creating shortages that put upward pressures on prices.

On balance, then, it does not appear that market forces by themselves can deal with all consumer concerns for safety, freedom from risk, and value. Market failures are characterised by inadequate consumer information, irrationality in the choices of consumers, and concentrated markets, undercut arguments that try to show that markets alone can provide adequate consumer protection. Instead, consumers must be protected through the legal structures of government and through the voluntary initiatives of responsible businesspeople.

3.5.1 The Contract View of the Business Firm's Duties to Consumers

According to the contract view of the business firm's duties to its customers, the relationship between a business firm and its customers is essentially a contractual relationship, and the firm's moral duties to the customer are those created by this contractual relationship. When a consumer buys a product, this view holds, the consumer voluntarily enters into a "sales contract" with the business firm. The firm freely and knowingly agrees to give the consumer a product with certain characteristics, and the consumer in turn freely and knowingly agrees to pay a certain sum of money to the firm for the product. By virtue of having voluntarily entered this agreement, the firm then has a duty to provide a product with those characteristics, and the consumer has a correlative right to get a product with those characteristics.

The contract theory of the business firm's duties to its customers rests on the view that a contract is a free agreement that imposes on the parties the basic duty of complying with the terms of the agreement. A person has a duty to do what the person contracts to do because failure to adhere to the terms of a contract is a practice that (a) cannot be universalised, and (b) treats the other person as a means and not as an end. Rawls's theory also provides a justification for the view, but one that is based on the idea that our freedom is expanded by the recognition of contractual rights and duties: An enforced system of social rules that requires people to do what they contract to do will provide them with the assurance that contracts will be kept. Only if they have such assurance will people feel able to trust each other's word and, on that basis, to secure the benefits of the institution of contracts. Traditional

moralists have argued that the act of entering into a contract is subject to several secondary moral constraints:

- Both parties to the contract must have full knowledge of the nature of the agreement they are entering.
- Neither party to a contract must intentionally misrepresent the facts of the contractual situation to the other party.
- Neither party to a contract must be forced to enter the contract under duress or undue influence.

These secondary constraints can be justified by the same sorts of arguments that Kant and Rawls use to justify the basic duty to perform one's contracts. Kant, for example, easily shows that misrepresentation in the making of a contract cannot be universalised, and Rawls argues that if misrepresentation were not prohibited, fear of deception would make members of a society feel less free to enter contracts. However, these secondary constraints can also be justified on the grounds that a contract cannot exist unless these constraints are fulfilled. A contract is essentially a free agreement struck between two parties. Because an agreement cannot exist unless both parties know what they are agreeing to, contracts require full knowledge and the absence of misrepresentation. Because freedom implies the absence of coercion, contracts must be made without duress or undue influence.

Hence, the contractual theory of business firms' duties to consumers claims that a business has four main moral duties: the basic duty of Complying with the terms of the sales contract and the secondary duties of:

- disclosing the nature of the product,
- avoiding misrepresentation, and
- avoiding the use of duress and undue influence by acting in accordance with these duties, a business respects the right of consumers to be treated as free and equal persons-that is, in accordance with their right to be treated only as they have freely consented to be treated.

The duty to comply explains the most basic moral duty that a business firm owes its customers, according to the contract view, is the duty to provide consumers with a product that lives up to those claims that the firm expressly made about the product, which led the customers to enter the contract freely and which formed the customers' understanding concerning what they were agreeing to buy.

The duty of disclosure is centred on an agreement that cannot bind unless both parties to the agreement know what they are doing and freely choose to do it. This implies that the seller who intends to enter a

contract with a customer has a duty to disclose exactly what the customer is buying and what the terms of the sale are. At a minimum, this means the seller has a duty to inform the buyer of any characteristics of the product that could affect the customer's decision to purchase the product. Some have argued that sellers should also disclose a product's components or ingredients, its performance characteristics, costs of operation, product ratings, and any other applicable standards.

The duty not to misrepresent expresses misrepresentation, even more than the failure to disclose information, renders freedom of choice impossible. That is, misrepresentation is coercive: The person who is intentionally misled acts as the deceiver wants the person to act and not as the person would freely have chosen to act if the person had known the truth. Because free choice is an essential ingredient of a binding contract, intentionally misrepresenting the nature of a commodity is wrong

The duty not to coerce explains how people often act irrationally when under the influence of fear or emotional stress. When a seller takes advantage of a buyer's fear or emotional stress to extract consent to an agreement that the buyer would not make if the buyer were thinking rationally, the seller is using duress or undue influence to coerce. An unscrupulous funeral director, for example, may skillfully induce guilt-ridden and grief-stricken survivors to invest in funeral services they cannot afford. Because entry into a contract requires freely given consent, the seller has a duty to refrain from exploiting emotional states that may induce buyers to act irrationally against their own best interests. For similar reasons, the seller also has the duty not to take advantage of gullibility, immaturity, ignorance, or any other factors that reduce or eliminate the buyer's ability to make free rational choices.

3.5.2 Problems with the Contractual Theory

The main objections to the contract theory focus on the unreality of the assumptions on which the theory is based. First, critics argue, the theory unrealistically assumes that manufacturers make direct agreements with consumers. Nothing could be farther from the truth. Normally, a series of wholesalers and retailers stands between the manufacturer and the ultimate consumer. The manufacturer sells the product to the wholesaler, who sells it to the retailer, who finally sells it to the consumer. The manufacturer never enters into any direct contract with the consumer. How then can one say that manufacturers have contractual duties to the consumer?

Advocates of the contract view of manufacturers' duties have tried to respond to this criticism by arguing that manufacturers enter into indirect agreements with consumers. Manufacturers promote their products through their own advertising campaigns. These advertisements supply the promises that lead people to purchase products from retailers, who merely function as "conduits" for the manufacturer's product. Consequently, through these advertisements, the manufacturer forges an indirect contractual relationship not only with the immediate retailers who purchase the manufacturer's product but also with the ultimate consumers of the product. The most famous application of this doctrine of broadened indirect contractual relationships is to be found in a 1960 court opinion, Henningsen v. Bloomfield Motors. Mrs. Henningsen was driving a new Plymouth when it suddenly gave off a loud cracking noise. The steering wheel spun out of her hands and the car lurched to the right and crashed into a brick wall. Mrs. Henningsen sued the manufacturer, Chrysler Corporation. The court opinion read.

- Under modern conditions the ordinary layman, on responding to the importuning of colourful advertising, has neither the opportunity nor the capacity to inspect or to determine the fitness of an automobile for use; he must rely on the manufacturer who has control of its construction, and to some degree on the dealer who, to the limited extent called for by the manufacturer's instructions, inspects and services it before delivery. In such a marketing milieu his remedies and those of persons who properly claim through him should not depend "upon the intricacies of the law of sales. The obligation of the manufacturer should not be based alone on privet of contract [that is, on a direct contractual relationship]. It should rest, as was once said, upon" 'the demands of social justice'" Mazett*i v. Ar7110us* &- *Co.* (1913). "If privity of contract is required," then, under the circumstances of modern merchandising, "privity of contract exists in the consciousness and understanding of all right thinking persons. . . ." Accordingly, we hold that under modern marketing conditions, when a manufacturer puts a new automobile in the stream of trade and promotes its purchase by the public, an implied warranty that it is reasonably suitable for use as such accompanies it into the hands of the ultimate purchaser. Absence of agency between the manufacturer and the dealer who makes the ultimate sale is immaterial.

Thus, Chrysler Corporation was found liable for Mrs. Henningsen's injuries on the grounds that its advertising had created a contractual relationship with Mrs. Henningsen and this contract created an "implied warranty" about the car, which Chrysler had a duty to fulfill.

In fact, sellers and buyers do not exhibit the equality that these doctrines assume. A consumer who must purchase hundreds of different kinds of commodities cannot hope to be as knowledgeable as a manufacturer who specialises in producing a single product. Consumers have neither the expertise nor the time to acquire and process the information on which they must base their purchase decisions. Consequently, consumers must usually rely on the judgment of the seller in making their purchase decisions and are particularly vulnerable to being harmed by the seller. Equality, far from being the rule, as the contract theory assumes, is usually the exception.

3.6 Advertising Ethics

Who pays for these advertising expenditures? In the end, advertising costs must be covered by the prices consumers pay for the goods they buy-the consumer pays.

What do consumers get for their advertising payment? According to most consumers, they get very little. Surveys have shown that 66 per cent of consumers feel that advertising does not reduce prices, 65 per cent believe it makes people buy things they should not buy, 54 per cent feel advertisements insult the intelligence, and 63 per cent feel advertisements do not present the truth. However, defenders of the advertising industry see things differently. Advertising, they claim, "is, before all else, communication." Its basic function is to provide consumers with information about the products available to them-a beneficial service.

Is advertising, then, a waste or a benefit? Does it harm consumers or help them?

3.6.1 Definition of Advertising

Commercial advertising is sometimes defined as a form of "information" and an advertiser as "one who gives information." The implication is that the defining function of advertising is to provide information to consumers. This definition of advertising, however, fails to distinguish advertisements from, say, articles in publications like Consumer Reports, which compare, test, and objectively evaluate the durability, safety, defects, and usefulness of various products. One study found that more than half of all television ads contained no consumer information whatsoever about the advertised product and that only half of all magazine ads contained more than one informational cue.

Advertisements often do not include much objective information for the simple reason that their primary function is not that of providing unbiased information. The primary function of commercial advertisements, rather, is to sell a product to prospective buyers, and whatever information they happen to carry is subsidiary to this basic function and usually determined by it.

A more helpful way of characterising commercial advertising is in terms of the buyer-seller relationship: Commercial advertising can be defined as a certain kind of communication between a seller and potential buyers. It is distinguished from other forms of communication by two features. First, it is publicly addressed to a mass audience as distinct from a private message to a specific individual. Because of this public feature, advertising necessarily has widespread social effects.

Second, advertising is intended to induce members of its audience to buy the seller's products. An advertisement can succeed in this intent in two main ways:

- by creating a desire for the seller's product in consumers and
- by creating a belief in consumers that the product is a means of satisfying some desire the buyer already has.

Discussion of the ethical aspects of advertising can be organised around the various features identified in the prior definition: its social effects, its creation of consumer desires, and its effects on consumer beliefs. We begin by discussing the social effects of advertising.

3.6.2 Advertising and its Effects on Consumers

The most common criticism of advertising concerns its effect on the consumer's beliefs. Because advertising is a form of communication, it can be as truthful or deceptive as any other form of communication. Most criticisms of advertising focus on the deceptive aspects of modern advertising.

Deceptive advertising can take several forms. An advertisement can misrepresent the nature of the product by using deceptive mock-ups, using untrue paid testimonials, inserting the word guarantee where nothing is guaranteed, and quoting misleading prices, failing to disclose defects in a product, misleadingly disparaging a competitor’s goods, or simulating well-known brand names. Some fraudulent forms of advertising involve more complex schemes. For example, bait advertisements announce the sale of goods that later prove not to be available or to be defective. Once consumers are lured into the store, they are pressured to purchase another, more expensive item.

A long ethical tradition has consistently condemned deception in advertising on the grounds that it violates consumers' rights to choose for themselves (a Kantian argument) and on the grounds that it generates a public distrust of advertising that diminishes the utility of this form and even of other forms of communication (the utilitarian argument). The central problem, then, is not understanding why deceptive advertising is wrong, but understanding how it becomes deceptive and, therefore, unethical.

All communication involves three elements: (a) the author(s) who originates the communication, (b) the medium that carries the communication, and (c) the audience who receives the communication. Because advertising is a form of communication, it involves these three elements, and the various ethical problems raised by the fact that it is a form of communication can be organised around them.

The moral issues raised by advertising are complex and involve several still unsolved problems. However, the following summarises the main factors that should be taken into consideration when determining the ethical nature of a given advertisement.

3.7 Consumer Privacy

Advances in computer processing power, database software, and communication technologies have given us the power to collect, manipulate, and disseminate personal information about consumers on a scale unprecedented in the history of the human race. This new power over the collection, manipulation, and dissemination of personal information has enabled mass invasions of the privacy of consumers and has created the potential for significant harms arising from mistaken or false information. For example, a pair of British investigators reported that in England, where companies register with the government the kind of information they will collect, businesses were collecting highly detailed and very personal information about their customers.

It is clear, then, that our interest in privacy is important enough to recognise it as a right that all people have, including consumers. However, this right must be balanced against the rights and legitimate needs of others. If banks are to provide loans to consumers, for example, they need to know something about the credit history of the individuals to whom they are providing loans and how diligent they have been in re-paying previous loans. Consumers ultimately benefit from such a banking system.

Insurance companies that want to provide life insurance to individuals need to know whether such individuals have any life-threatening illnesses, and so they must have access to their medical information. Consumers benefit from having life insurance available to them. Thus, there are significant consumer benefits that businesses can provide but that they can provide only if there exist agencies that can collect information about individuals and make that information available to those businesses. Thus, consumers' rights to privacy have to be balanced with these legitimate needs of businesses. Several considerations have been suggested as key to balancing legitimate business needs with the right to privacy, including (a) relevance, (b) informing, (c) consent, (d) accuracy, (e) purpose, and (f) recipients and security.

3.8 Consumerism

The demand on businesses for ethical practices has been further fuelled by consumerism. Consumerism is the organised movement of consumers/customers and government aimed at aiding and protecting the rights, interests and powers of consumers/customers by exerting legal, moral and economic pressures on business organisations. It can also be seen as protest by consumers against real and/or perceived injustices and efforts to remedy injustices perceived by consumers. The protest may also be against marketing malpractices and injustice and adverse effects of business activities on the environment.

Consumerism is on the rise. This is because consumers are more educated, knowledgeable, and organised. They are demanding better consumer information, quality service, and dependability, and fair prices. The consumerism movement is one reason businesses need to adopt an ethical perspective.

What consumer rights? Much of the current interest in marketing responsibility towards customers can be traced on the rise of consumerism-social activism dedicated to protecting the rights of consumers in their dealing with businesses. The first former declaration of consumer rights protection came in 1962 when President John F. Kennedy identified four basic consumer rights. Since that time, a general agreement on four additional rights has also emerged. In all we can now talk of 8 consumer rights. These include:

- **Consumers have a right to save products:** marketers can’t knowingly sell products that they suspect of being defective. For example, a central legal argument is the recent problem involving Firestone tyres. The bone of contention was whether or not company officials knew in advance that the firm was selling defective tyres.

- **Consumers have a right to be informed about relevant aspects of a product:** for example, apparel manufacturers are now required to provide full disclosure on all fabrics used (cotton, silk, polyester, and so forth) and instruction for (dry-clean, machine wash, hand wash).

- **Consumers have a right to be heard:** consumers must be given the opportunity to register their complaints about poor product or service delivery. Labels on products sold should carry telephone numbers and/or Web site of the marketers.

- **Consumers have a right to choose what they buy:** consumers should be able to choose from a whole range of products supplied by a firm and competitors. There should be no competitive restriction on what should be made available to consumers.

- **Consumers have a right to be educated about purchases:** all prescription drugs and foods now come with detailed information regarding dosage, possible side effect, expiry date, caution and potential interactions with other medications.

- **Consumers have a right to basic needs:** the basic needs of life worldwide include food, shelter, clothing, healthcare and transportation. Every government should provide these basic needs to guarantee consumers' minimum standard of living.

- **Consumers have a right to representation:** this becomes necessary where the rights of consumers have been trampled upon. Consumers suffering from any form of infringements can seek redress in law courts, tribunals and regulatory authorities.

- **Consumers have a right to a good environment:** because companies' productive, marketing, and distributive activities sometimes cause environmental degradation, which affects the quality of life of consumers, consumers need to be insulated from this right.

3.9 Public and other Actions to Protect Consumers in Nigeria

Various measures have been taken to protect consumers in Nigeria. Various individuals, organisations and governments have attempted to protect consumers in Nigeria. The various measures for protecting consumers are:

1. **Government Economic and Social Policy Measures**

- Promulgation of the Price Control Decree of 1970. It was aimed at checking profiteering and hoarding.
- Establishment of Standards Organisation of Nigeria (SON), National Agency for Food and Drugs Administration and Control (NAFDAC), Nigerian Communications Commission (NCC), National Broadcasting Commission (NBC) and several other agencies .

They were set up for the following reasons.

- To continuously formulate laws and regulations aimed at protecting consumers.
- To cater for the welfare of consumers.
- NAFDAC ensures that manufactured foods and drugs are tested, duly approved and registered with the container carrying the registration number as stamp of authority and assurance to consumers.
- SON ensures that goods and services conform to set minimum quality levels.
- it stipulates weights and measures to be used by organisations.
- NCC ensures that telecommunications companies pursue minimum standards at reasonable rates.

2. **Newspapers and Magazines:** Most newspapers and government agencies' magazines devote sections regularly to consumer awareness.

For instance, there was a media report on how some Nigerian oil marketers rip off Nigerian motorists. Oil marketers such as Oando, Conoil, and Global Feet oil, Sea Petroleum and Gas and Ine Oil Filling Stations were found to have tampered with their pumps, dispensing lower value of Premium Motor Spirit (PMS) to their customers. In a report by Department of Petroleum Resources (DPR), following the inspection exercise it carried out in the Lekki area of Lagos, customers lose 1.2 litres of PMS in every 10 litres of the product bought in Conoil, 0.8 litres in Oando and 0.6 litres in Texaco.

3. **Formation of Tenants Associations and Consumers Associations:** This is to protect consumers by taking all necessary actions within the law to minimise exploitation.

4. **Introduction of Consumer Suggestion Box**: This is used by some organisations to encourage consumers' complaints and suggestions. How well consumers employ this avenue to air their

grievances and how efficiently organisations react is a matter that should really concern customer-oriented organisations.

5. **Consumers' Boycott**: This is a threat or decision by a group of customers to stop buying a particular product or service for reasons such as high price, poor quality and poor services. For instance, a boycott of GSM service was undertaken in Nigeria a few years ago.

4.0 CONCLUSION

Competition will emerge in industries that are concentrated with firms producing similar products. Manufacturers must go to a large extent to ensure their products are safe for consumption and must not embark on false advertisement of their products.

5.0 SUMMARY

Free markets cannot be secured unless the firms maintain competitive market relationships among themselves. The ethical rules prohibiting collusion are meant to ensure that markets are structured competitively. Manufacturers have moral duties to consumers under the contractual theory. They must desist from giving false information to consumers as this is against marketing ethics

6.0 TUTOR MARKED ASSIGNMENT

1. Explain why firms have to advertise their products?
2. Differentiate between a monopolistic market and oligopoly.

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UNIT 4 ETHICS AND ENVIROMENTALISM

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1.0 INTRODUCTION

Environmental issues raise large and complicated ethical and technological questions for our business society. What is the extent of the environmental pollution produced by present and projected industrial technology? How large a threat, that is, damage, is posed to our welfare? What values must we give up to halt or slow such damage? Whose

rights are violated by pollution and who should be given the responsibility of paying for the costs of polluting the environment? How long will our natural resources last? What obligations do firms have to future generations to preserve the environment and conserve our resources?

This unit explores these environmental issues. It begins with an assessment of the various technical aspects of environmental resource use. This is followed by a discussion of the ethical basis of environmental protection. The final sections will discuss two controversial issues: our obligations to future generations and the prospects for continued economic growth.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define environmentalism
- describe the two main sources of threats to the environment
- explain ethical issues raised by pollution from commercial and industrial enterprises
- explain obligations that we have to conserve our resources.

3.0 MAIN CONTENT

3.1 Environmentalism

Environmentalism is also referred to as the “Green Movement” and should not be confused with consumerism. Environmentalism is concerned with the ecology and with maximising life quality. Consumerism is concerned with ensuring that the consumer is treated fairly and that the consumer’s rights are respected.

Environmentalists are concerned with issues that affect the global environment upon which we all depend. Probably the issue that has caused the widest concern is the so-called hole in the ozone layer and theh greenhouse effect which is forecast to make major changes to our climate.

Of concern are such issues as strip mining, forest depletion, the effluent from factories, some nuclear waste and the destruction of wildlife habitat to build new motorways. Quality of life issues such as loss of recreational areas, excessive outdoor advertising and litter also fall within the limit.

Environmentalists are not opposed to marketing – their desire is to ensure that organisations, and individuals, operate on good ecological principles. That decision is evaluated for their impact on the environment with only those that have positive value being progressed. Thus, environmentalism is at first a concern of top management since its principles must be adopted at corporate level, as policy, before an organisation can properly adopt them throughout.

Environmental protection naturally incurs cost, which raises prices, and so many organisations are reluctant to take the long-term decisions for fear of doing short-term harm. As the "Green Movement" gathers pace, however, it is becoming obvious that consumers are pressing for environmentally sound products and services and as this shift becomes established as a consumer need, it is hoped that managements will respond, not least because it will be in their short- as well as long-term interests.

3.1.1 The Dimensions of Pollution and Resource Depletion

Environmental damage inevitably threatens the welfare of human beings as well as plants and animals. Threats to the environment come from two sources: pollution and resource depletion. Pollution refers to the undesirable and unintended contamination of the environment by the manufacture or use of commodities. Resource depletion refers to the consumption of finite or scarce resources. In a certain sense, pollution is really a type of resource depletion because contamination of air, water, or land diminishes their beneficial qualities. But for purposes of discussion, we keep the two issues distinct.

3.2 Air Pollution

Air pollution is not new; it has been with us since the Industrial Revolution introduced the world to the belching factory smokestack. However, the costs of air pollution increased exponentially as industrialisation expanded. Today, air pollutants affect vegetation, decrease agricultural yields and inflict losses on the timber industry; they deteriorate exposed construction materials through corrosion, discoloration, or rot; they are hazardous to health and life, raising medical costs and lessening the enjoyment of living; and they pose catastrophic global damage in the form of global warming and destruction of the stratospheric ozone layer.

3.2.1 Global Warming

Carbon dioxide, nitrous oxide, methane, and chlorofluorocarbons are gases that absorb and hold heat from the sun, preventing it from

escaping back into space; much like a greenhouse absorbs and holds the sun's heat. Greenhouse gases occur naturally in the atmosphere where they have kept the earth's temperature about 33°C warmer than it would otherwise be, enabling life as we know it to evolve and flourish. However, industrial, agricultural, and other human activities during the last 150 years have released substantially more greenhouse gases into the atmosphere, particularly by the burning of fossil fuels such as oil and coal.

Since the beginning of the industrial era, the amount of carbon dioxide in the atmosphere has increased by 25 per cent. Measurements at Mauna Loa, Hawaii, indicate that carbon dioxide is currently increasing at the rate of 1.4 per cent a year and that this rate accelerates each passing year. Computer models indicate that rising levels of greenhouse gases will trap increasing amounts of heat on earth and so will raise temperatures around the globe. Average global temperatures are now 1°C (l.8°F) higher than in 1900 and are expected to rise by 1.5° to 4.5°C during this century. This rising heat will expand the world's deserts; melt the polar ice caps, causing sea levels to rise; make several species of plants and animals extinct; disrupt farming; and increase the distribution and severity of diseases. All these are eminent in the Niger-Delta region of Nigeria.

3.2.2 Ozone Depletion

Of equally serious concern is the gradual breakdown of ozone gas in the stratosphere above us caused by the release of chlorofluorocarbons (CFCs) into the air. A layer of ozone in the lower stratosphere screens all life on earth from harmful ultraviolet radiation. This ozone layer, however, is destroyed by CFC gases, which have been used in aerosol cans, refrigerators, air conditioners, industrial solvents, and industrial foam blowers. When released into the air, CFC gases rise; in 7 to 10 years, they reach the stratosphere, where they destroy ozone molecules and remain for 75 to 130 years, continuing all the while to break down additional ozone molecules. Worldwide monitoring data indicate that global average losses of the ozone layer have totalled about 5 percent since the 1960s, with cumulative losses of about 10 percent in the winter and spring and 8 percent in the summer and autumn over Europe, North America, and Australia. Studies predict that the shrinking of the ozone layer and the subsequent increase of ultraviolet rays will cause several hundred thousand new cases of skin cancer and may cause considerable destruction of the 75 per cent of the world's major crops that are sensitive to ultraviolet light. Other studies caution that the plankton that float on the surface layers of the earth's oceans and on which the entire food chain of the world's oceans ultimately depends is sensitive to ultraviolet light and may suffer mass destruction. International agreements

to which the United States is a party pledged to gradually phase out the use of CFC gases by 2000, and emissions of CFCs have dropped by 87 percent from their peak in 1988. However, scientists warn that even if the use of CFC gases were completely halted, CFC levels in the atmosphere would still continue their dangerous upward climb because those gases already released will continue to rise upward for many years and will persist for perhaps a century. Moreover, not all countries have agreed to cease making and producing CFC gases, and CFC gases are often released when refrigeration or air-conditioning systems built many years ago are repaired or disposed of.

3.2.3 Acid Rain

Acid rain is a threat to the environment that, like global warming, is closely related to the combustion of fossil fuels (oil, coal, and natural gas), which are heavily used by utilities to produce electricity. Burning fossil fuels, particularly coal containing high levels of sulfur, releases large quantities of sulfur oxides and nitrogen oxides into the atmosphere. Electric utility plants account for 70 per cent of annual sulfur oxide emissions and 30 per cent of nitrogen oxides. When these gases are carried into the air, they combine with water vapour in clouds to form nitric acid and sulfuric acid. These acids are then carried down in rain, which often falls hundreds of miles away from the original sources of the oxides.

The acidic rainfall sometimes as acidic as vinegar is carried into lakes and rivers, where it raises the acidity of the water. It also soaks into soils and falls directly on trees, grasses, and other vegetation. Numerous studies have shown that many fish populations and other aquatic organisms-including algae, zooplankton, and amphibians-are unable to survive in lakes and rivers that have become highly acidic due to acid rain.

Other studies have shown that acid rain directly damages or destroys trees, plants, lichens, and mosses and indirectly destroys the wildlife and species that depend on forests for food and breeding. Acidic rainwater can also leach toxic metals cadmium, nickel, lead, manganese and mercury-from soil and carry these into waterways, where they contaminate drinking water or fish. Finally, acid rain can corrode and damage buildings, statues, and other objects, particularly those made of iron, limestone, and marble. Dozens of people were killed in West Virginia when a steel bridge collapsed as a result of acid rain corrosion, and priceless monuments such as the Acropolis in Athens and the Taj Mahal in India have been corroded by acid rain. Many researchers fear that future emissions will devastate the world's forests, particularly those located near industrial centres.

Acid rain is an international problem. Acid rain that falls on one country often has its origins in sulfur and nitrogen oxides produced in another country and blown by prevailing winds. Much of Canada and the northeastern part of the United States, for example, are subject to acid rain whose origins lie in industrial areas around the Great Lakes, and the Netherlands have suffered from acid rain that has its origins in Germany.

3.2.4 Airborne Toxics

Less catastrophic but highly worrisome air pollution threats are the 2.4 billion pounds of airborne toxic substances released annually into the western nation's atmosphere, including phosgene, a nerve gas used in warfare, and methyl isocyanate, which killed more than 2,000 Indians in Bhopal. The chemical brew released into the air annually includes 235 million pounds of carcinogens, such as benzene and formaldehyde, and 527 million pounds of such neurotoxins as toluene and trichloroethylene.

Although levels of most airborne toxics have been declining gradually across the world, some western countries have registered increases in the levels of several carcinogenic toxics in the air. Airborne toxics are highly present in the industrial cities like Lagos and Port-Harcourt in Nigeria. The Environmental Protection Agency (EPA) has estimated that 20 of the more than 329 toxics released into the air alone cause more than 2,000 cases of cancer each year and that living near chemical plants raises a person's chances of cancer to more than 1 in 1,000. Exceptionally high cancer rates have been found near plants in several places, e.g., West Virginia and Louisiana and in Lagos, Port-Harcourt and the Niger-delta region.

3.2.5 Air Quality

The most prevalent forms of air pollution, however, are the gases and particulates spewed out by autos and industrial processes, which affect the quality of the air we breathe. The six "principal air pollutants" for which the EPA sets "national air quality standards" are carbon monoxide, sulfur oxides, nitrogen oxides, ozone (or photochemical smog), particulates, and airborne lead. The effects of these pollutants were recognised more than two decades ago.

More recent long-range studies have indicated that the deterioration of lung function in human beings caused by their chronic exposure to air pollutants, whether it is auto smog or industrial smokestack emissions, is long lasting and often irreversible. Some of the 2,500 subjects in the

studies suffered as much as 75 per cent loss of lung capacity during a l0-year period of living in Los Angeles communities-a region with very high levels of air pollution-leaving them vulnerable to respiratory dis-ease, emphysema, and impairment of their stamina. Damage to the still-developing lungs of children was especially problematic. All these are recorded in Lagos, being the commercial and industrial nerve centre of Nigeria. The Niger-delta, with its heavy pollution as a result of the activities of oil companies present in those parts is also affected.

The major sources of the pollution that affects air quality are utilities, industrial smokestacks, and automobiles. In congested urban areas, an estimate of the proportion of air pollution caused by automobiles, rises to as much as 80 per cent. Industrial pollution is derived principally from power plants and plants that refine and manufacture basic metals. Electrical power plants that depend on fossil fuels such as oil, coal, or natural gas throw tons of sulfur oxides, nitrogen oxides, and ashes into the air. When taken into the lungs, sulfur oxides form sulfuric acid, which damages the linings of the lungs and causes emphysema and bronchitis. Sulfur oxides have also been found to be a major factor in infant deaths, and particulates have been implicated in deaths from pneumonia and influenza. As mentioned earlier, sulfur oxides and nitrogen oxides also produce acid rain. Copper refineries and smelters produce large quantities of copper oxides and ash, and steel, nickel, cement, and chemical plants produce a variety of airborne particulates.

The health costs of low air quality are known to be high. Studies have indicated that when the concentrations of sulfur oxides over our major cities were cut in half from their 1960 levels, this added an average of 1 year to the live of each of their residents. If air quality in urban areas were similar to the levels of rural regions with clean air, the deaths rates for asthma, bronchitis, and emphysema would drop by about 50 percent, and deaths from heart disease would drop by about 15 percent. Improvements in air quality since 1970, it is believed, now save about 14,000 lives per year.

3.3 Water Pollution

The contamination of water sources is an old problem one that has been with us since civilisation began using water to dispose of its wastes and sewage. Water pollutants today, however, are much more diverse, consisting not only of organic wastes but also dissolved salts, metals, and radioactive materials as well as suspended materials such as bacteria, viruses, and sediments. These can impair or destroy aquatic life, threaten human health, and foul the water. About 40 per cent of our surface water today is too polluted to fish or swim in. Water pollutants enter surface water or underground water basins either from a single or

point source, such as a pipe or a well carrying sewage or industrial wastes, or they enter from a diffused or no point source covering a large area, such as crop pesticides or animal wastes carried in rainwater or runoff.

3.3.1 Organic Wastes

In water are comprised, in large part, of untreated human wastes and sewage, but a substantial amount is also derived from industrial processing of various food products, from the pulp and paper industry, and from animal feedlots. Organic wastes that find their way into water resources are consumed by various types of bacteria, which in the process deplete the water of its oxygen. The oxygen-depleted water then becomes incapable of supporting fish life and other organisms.

Phosphorus compounds also contaminate many of our water sources. Phosphorus compounds are found in cleansing detergents used both domestically and industrially, in fertilizers used for agricultural purposes, and in untreated human and animal sewage. Lakes with high concentrations of phosphorus give rise to explosive expansions of algae populations that choke waterways, drive out other forms of life, deplete "I the water of its oxygen, and severely restrict water visibility.

3.4 Land Pollution

3.4.1 Toxic Substances

Hazardous or toxic substances are those that can cause an increase in mortality rates or irreversible or incapacitating illness or those that have other seriously adverse health or environmental effects. Toxic substances released on land include acidic chemicals, inorganic metals (such as mercury or arsenic), flammable solvents, pesticides, herbicides, phenols, explosives, and so on. (Radioactive wastes are also classified as hazardous substances, but these are discussed separately later.).

3.4.2 Depletion of Species and Habitats

It is well known that human beings have depleted dozens of plant and animal species to the point of extinction. Since 1600 A.D., at least 63 major identifiable species of mammals and 88 major identifiable species of birds are known to have become extinct. Several hundred more species, such as whales and salmon, today find themselves threatened by commercial predators. Forest habitats on which the bulk of species depend are also being decimated by the timber industry. Experts estimate that the planet's rain forests are being destroyed at the rate of about 1 percent a year. The loss of forest habitats combined with the effects of pollution is thought to have led to the extinction of a

phenomenal number of species. A recent comprehensive study of 18,000 species and subspecies around the world found that 11,046 of them were in danger of disappearing forever. It is estimated that between half a million to two million species (15 to 20 percent of all species on earth) were rendered extinct by 2000.

3.4.3 Depletion of Fossil Fuels

Until the early 1980s, fossil fuels were being depleted at an exponentially rising rate. That is, the rate at which they were being used had doubled with the passage of a regular fixed time period. Some early predictions of resource depletion assumed that fossil fuels would continue to be depleted at these exponentially rising rates. If continued, an exponentially rising rate of depletion would end with the complete and catastrophic depletion of the resource in a relatively short time. Estimated world resources of coal would be depleted in about 100 years, estimated world reserves of oil would be exhausted in about 40 years, and estimated reserves of natural gas would last only about 25 years.

Researchers point out, however, that our consumption of fossil fuels could not continue rising at historical exponential rates. As reserves of any resource shrink, they become increasingly difficult, and therefore more costly, to extract, this in turn slows down their depletion rates. Consequently, although the rates at which reserves are depleted may rise exponentially for a period, the rising costs of extraction eventually cause the rates to peak and then begin to decline without complete depletion ever being attained.

3.4.4 Depletion of Minerals

The depletion of mineral reserves, like the depletion of fossil fuels, can also be calculated either on the basis of an exponential growth model or on the basis of a peaked growth model. If earlier exponentially rising rates of depletion continued, then aluminum would have been scheduled for exhaustion in the year 2003, iron in 2025, manganese in 2018, molybdenum in 2006, nickel in 2025, tungsten in 2000, zinc in 1990, and copper and lead in 1993. Clearly, if these depletion schedules were correct, the economic consequences would be catastrophic because running out of these essential minerals within these relatively short time frames would lead to a collapse of numerous industries that rely on them. During the early 1970s, many researchers believed that such an industrial and economic collapse was imminent. However, further research has indicated that such catastrophic depletion schedules were mistaken. There are physical limits, then, to our natural resources: Although many are abundant, they cannot be exploited indefinitely. Eventually they will peter out and the costs of extraction will rise

exponentially. More plentiful substitute materials may be found for many of these resources, but it is likely that substitutes cannot be found for all of them. Whatever substitutes are developed will also be limited, so the day of reckoning will only be delayed.

3.5 The Ethics of Pollution Control

For centuries, business institutions were able to ignore their impact on the natural environment, an indulgence created by a number of causes. First, business was able to treat air and water as free goods-that is, as goods that no one owns and that each firm can therefore use without reimbursing anyone for their use. For several years, for example, a DuPont plant in West Virginia had been dumping 10,000 tons of chemical wastes each month into the Gulf of Mexico until it was forced to stop. The waters of the Gulf provided a free dumping site for whose damages DuPont did not have to pay. Because such resources are not privately owned, they lack the protection that a private owner would normally provide, and businesses were able to ignore the damages they inflicted on them.

Second, businesses have seen the environment as an unlimited good. That is, the "carrying capacity" of air and water is relatively large, and each firm's contribution of pollution to these resources is relatively small and insignificant. The amount of chemicals DuPont was dumping into the Gulf, for example, might be relatively small compared with the size of the Gulf and the effects viewed as being negligible. When the effects of its activities are seen as so slight, a firm will tend to ignore these effects. However, when every firm reasons in this way, the combined negligible effects of each firm's activities may become enormous and potentially disastrous. The carrying capacity of the air and water is soon exceeded, and these free and unlimited goods rapidly deteriorate.

Of course, pollution problems are not rooted only in business activities. Pollution also results from the use that consumers make of products and from human waste products. A primary source of air pollution, for example, is automobile use, and a primary source of water pollution is sewage. We are truly all polluters. Because every human being pollutes, pollution problems have increased as our population has multiplied. The world's population grew from 1 billion in 1850 to 2 billion in 1930 to 6.3 billion in 2003 and is projected to grow to 8.9 billion by 2050. This population explosion has put severe strains on the air and water resources into which we dump our share of pollutants. Moreover, these strains have been aggravated by our tendency to concentrate our populations in urban centres. All over the world, urban areas are growing rapidly, and the high-population densities that urbanisation has

created multiplies the pollution burdens placed on air and water resources.

The problems of pollution, then, have a variety of origins, and their treatment requires a similarly variegated set of solutions. Our focus in what follows, however, concentrates on a single range of problems: the ethical issues raised by pollution from commercial and industrial enterprises.

In controlling pollution, the injection of harmful substances into the environment - is a significant challenge for several business firms. Although noise pollution is now attracting increased concern, air, water, and land pollution remains the greatest problem and need of solution from government and business alike.

3.5.1 Ecological Ethics

The problem of pollution (and environmental issues in general) is seen by some researchers as a problem that can best be framed in terms of our duty to recognise and preserve the ecological systems within which we live. An ecological system is an interrelated and interdependent set of organisms and environments, such as a lake-in which the fish depend on small aquatic organisms, which in turn live off decaying plant and fish waste products. Because the various parts of an ecological system are interrelated, the activities of one of its parts will affect all the other parts. Because the various parts are interdependent, the survival of each part depends on the survival of the other parts. Business firms (and all other social institutions), are parts of a larger ecological system, "spaceship earth." Business firms depend on the natural environment for their energy, material resources, and waste disposal, and that environment in turn is affected by the commercial activities of business firms.

Unless businesses recognise the interrelationships and interdependencies of the ecological systems within which they operate and unless they ensure that their activities will not seriously injure these systems, we cannot hope to deal with the problem of pollution.

The fact that we are only a part of a larger ecological system has led many writers to insist that we should recognise our moral duty to protect the welfare not only of human beings but also of other non human parts of this system. This insistence on what is sometimes called ecological ethics or deep ecology is not based on the idea that the environment should be protected for the sake of human beings. Instead, ecological ethics is based on the idea that non human parts of the environment deserve to be preserved for their own sake, regardless of whether this

benefits human beings. Several supporters of this approach have formulated their views in a platform consisting of the following statements:

- The well-being and flourishing of human and non-human life on earth have value in themselves. These values are independent of the usefulness of the non human world for human purposes.
- Richness and diversity of life forms contribute to the realisation of these values and are also values in themselves.
- Humans have no right to reduce this richness and diversity except to satisfy vital needs.
- The flourishing of human life and cultures is compatible with a substantial decrease of the human population. The flourishing of non human life requires such a decrease.
- Present human interference with the non human world is excessive, and the situation is rapidly worsening.
- Policies must therefore be changed. The changes in policies affect basic economic, technological, and ideological structures. The resulting state of affairs will be deeply different from the present.
- The ideological change is mainly that of appreciating life quality rather than adhering to an increasingly higher standard of living.
- Those who subscribe to the foregoing points have an obligation directly or indirectly to participate in the attempt to implement the necessary changes.

An ecological ethic is thus an ethic that claims that the welfare of at least some non-humans is intrinsically valuable and that, because of this intrinsic value, we humans have a duty to respect and preserve them. These ethical claims have significant implications for those business activities that affect the environment.

3.5.2 Environmental Rights and Absolute Bans

In an influential article, William T. Blackstone argued that the possession of a livable environment is not merely a desirable state of affairs, but something to which each human being has a right. That is, a livable environment is not merely something that we would all like to have: It is something that others have a duty to allow us to have. They have this duty, Blackstone argued, because we each have a right to a livable environment, and our right imposes on others the correlative duty of not interfering in our exercise of that right. This is a right, moreover, that should be incorporated into our legal system.

Why do human beings have this right? According to Blackstone, a person has a moral right to a thing when possession of that thing is “essential in permitting him to live a human life” (i.e., in permitting him

to fulfill his capacities as a rational and free being). At this time in our history, it has become clear that a livable environment is essential to the fulfillment of our human capacities. Consequently, human beings have a moral right to a decent environment, and it should become a legal right. Moreover, Blackstone adds, this moral and legal right should override people's legal property rights. Our great and increasing ability to manipulate the environment has revealed that, unless we limit the legal freedom to engage in practices that destroy the environment, we shall lose the very possibility of human life and the possibility of exercising other rights, such as the right to liberty and equality.

Several states have introduced amendments to their constitution that grant to their citizens an environmental right, much like Blackstone advocated.

The main difficulty with Blackstone's view, however, is that it fails to provide any nuanced guidance on several pressing environmental choices. How much pollution control is really needed? Should we have an absolute ban on pollution? How far should we go in limiting property rights for the sake of the environment? What goods, if any, should we cease manufacturing to halt or slow environmental damage? Who should pay for the costs of preserving the environment? Blackstone's theory gives us no way of handling these questions because it imposes a simple and absolute ban on pollution.

This lack of nuance in the absolute rights approach is especially problematic when the costs of removing certain amounts of pollution are high in comparison to the benefits that will be attained.

3.5.3 Markets and Partial Controls

One way to answer the questions that Blackstone's theory of environmental rights leaves unanswered is to see environmental problems as market defects. If an industry pollutes the environment, the market prices of its commodities will no longer reflect the true cost of producing the commodities; the result is a misallocation of resources, a rise in waste, and an inefficient distribution of commodities. Consequently, society as a whole is harmed as its overall economic welfare declines.

Marketers who are environmentally aware need to check into the environmental results of their potential actions. All the potential consequences of product decision have to be identified and taken into account. This includes everything from the damage arising from extraction and transport of raw materials to the production process and its wastes, and on into package design and disposal. Environmentalists

are concerned about the excessive packaging which, even at a minimum, wastes precious natural resources and they are concerned about promotion that encourages conspicuous and unnecessary consumption.

Individuals, then, should avoid pollution because they should avoid harming society's welfare. The following paragraphs explain this argument in greater detail and explain the more nuanced approach to pollution that this market analysis seems to provide.

3.6 The Ethics of Conserving Depletable Resources

Conservation refers to the saving or rationing of natural resources for later uses. Conservation, therefore, looks primarily to the future: to the need to limit consumption now to have resources available for tomorrow.

In a sense, pollution control is a form of conservation. Pollution "consumes" pure air and water, and pollution control "conserves" them for the future. However, there are basic differences between the problems of pollution and the problems of resource depletion that makes the term conservation more applicable to the latter problems than to the former. With some notable exceptions (such as nuclear wastes), most forms of pollution affect present generations, and their control will benefit present generations.

The depletion of most scarce resources, however, lies far in the future, and the effects of their depletion will be felt primarily by posterity and not by present generations. Consequently, our concern over the depletion of resources is primarily a concern for future generations and for the benefits that will be available to them. For this reason, conservation is more applicable to the problems of resource depletion than to those of pollution. Moreover (again with notable exceptions), pollution is a problem concerned primarily with "renewable" resources, insofar as air and water can be "renewed" by ceasing to dump pollutants into them and allowing them time to recover.

Tomorrow's supply, therefore, will be created anew over and over if we take the proper precautions. Resource depletion, however, is concerned with finite, nonrenewable resources. The only store of a finite, nonrenewable resource that will be around tomorrow is that which is left over from today. Conservation, therefore, is the only way of ensuring" a supply for tomorrow's generations Resource depletion forces two main kinds of questions on us. Why should we conserve resources for future generations? How much should we conserve?

3.6.1 Rights of Future Generations

It might appear that we have an obligation to conserve resources for future generations because they have an equal right to the limited resources of this planet. If future generations have an equal right to the world's resources, then by depleting these resources, we are taking what is actually theirs and violating their equal right to these resources.
A number of writers, however, have claimed that it is a mistake to think that future generations have rights. Consequently, it is a mistake to think that we should refrain from consuming natural resources because we are taking what future generations have a right to. Three main reasons have been advanced to show that future generations cannot have rights.

First, future generations cannot intelligently be said to have rights because they do not now exist and may never exist. I may be able to think about future people, but I cannot hit them, punish them, injure them, or treat them wrongly.

Second, if future generations did have rights, we might be led to the absurd conclusion that we must sacrifice our entire civilisation for their sake.

Third, we can say that someone has a certain right only if we know that he or she has a certain interest which that right protects. The purpose of a right, after all, is to protect the interests of the right holder, but we are virtually ignorant of what interests future generations will have.

If these arguments are correct, then to the extent that we are uncertain what future generations will exist or what they will be like, they do not have any rights. It does not follow, however, that we have no obligations to any future generations, because our obligations may be based on other grounds.

3.6.2 Justice to Future Generations

John Rawls argued that, although it is unjust to impose disproportionately heavy burdens on present generations for the sake of future generations, it is also unjust for present generations to leave nothing for future generations. To determine a just way of distributing resources between generations, he suggested, the members of each generation should put themselves in the "original position" and, without knowing what generation they belong to, they should do the following.

- Ask what is reasonable for members of adjacent generations to expect of one another at each level of (historical) advance. They

should try to piece together a just savings schedule by balancing how much at each stage (of history) they would be willing to save for their immediate descendants against what they would feel entitled to claim of their immediate predecessors. Thus, imagining themselves to be parents, say, they are to ascertain how much they would set aside for their children by noting what they would believe themselves entitled to claim of their own parents.

In general, Rawls claims that this method of ascertaining what earlier generations in justice owe to later generations will lead to the conclusion that what justice demands of us is merely that we hand to the next generation a situation no worse than we received from the generation before us.

- Each generation must not only preserve the gains of culture and civilisation, and maintain intact. those just institutions that have been established, but it must also put aside in each period of time a suitable amount of real capital accumulation. (It should be kept in mind here that capital is not only factories, and machines, and so on, but also the knowledge and culture, as well as the techniques and skills, that make possible just institutions and the fair value of liberty.) This is in return for what is received from previous generations that enables the later ones to enjoy better life in a more just society.

3.6.3 Economic Growth

However, to many observers, conservation measures fall far short of what is needed. Several writers have argued that if we are to preserve enough scarce resources so that future generations can maintain their quality of life at a satisfactory level, we shall have to change our economies substantially, particularly by scaling down our pursuit of economic growth. E. F. Schumacher, for example, claimed that the industrialised nations will have to convert from growth-oriented, capital-intensive technologies to much more labour-intensive technologies in which humans do work machines now do. Others argue that economic systems will have to abandon their goal of steadily increasing production and put in its place the goal of decreasing production until it has been scaled down to “a steady state” that is, a point at which "the total population and the total stock of physical wealth are maintained constant at some desired levels by a ‘minimal’ rate of maintenance throughout (that is, by birth and death rates that are equal at the lowest feasible level, and by physical production and consumption rates that are equal at the lowest feasible level)." The conclusion that economic growth must be abandoned if society is to be able to deal with the

problems of diminishing resources has been challenged. It is at least arguable that adherence to continual economic growth promises to degrade the quality of life of future generations.

The arguments for this claim are simple, stark, and highly controversial. If the world's economies continue to pursue the goal of economic growth, the demand for depletable resources will continue to rise. Because world resources are finite, at some point supplies will simply run out. At this point, if the world's nations are still based on growth economies, we can expect a collapse of their major economic institutions (i.e., of manufacturing and financial institutions, communication networks, the service industries), which in turn will bring down their political and social institutions (i.e., centralised governments, education and cultural programmes, scientific and technological development, health care).

Living standards will then decline precipitously in the wake of widespread starvation and political dislocations. Various scenarios for this sequence of events have been constructed, all of them more or less speculative and necessarily based on uncertain assumptions. The most famous and oldest of these are the studies of the Club of Rome, which over two decades ago projected on computers the catastrophic results of continuing the economic growth patterns of the past in the face of declining resources. Later studies came to similar conclusions.

SELF ASSESSMENT EXERCISE

Define the following concepts: pollution, toxic substance, nuclear wastes, exponential depletion, peaked depletion, free good, unlimited good, ecological system, ecological ethic, right to a livable environment, absolute ban, private costs, social costs, external costs, to internalize costs, cost-benefit analysis, risk, social audit, right of consent, conservation, rights of future generations, justice toward future generations, multiple access, time preference, doomsday scenario, high-consumption nation.

4.0 CONCLUSION

It is very important that we understand how important it is to take care of our environment, and as a corporate organisation, the internal and external cost of pollution in order to reassert justice.

5.0 SUMMARY

Ethics demands that we should:

- leave the world no worse than we found it
- leave our children a world no worse than we received
- leave the world as productive as we found it

6.0 TUTOR-MARKED ASSIGNMENT

1. Define the main forms of pollution and resource depletion and identify the major problems associated with each form.
2. Do you agree with the claims that (a) future generations have no rights, and (b) the future generations to which we have obligations actually include only the generation that will immediately succeed us? Explain your answer. If you do not agree with these claims, state your own views, and provide arguments to support them.

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MODULE 3

Unit 1 Ethics of Job Discrimination
Unit 2 Individual in the Organisation
Unit 3 Corporations and Corporate Governance I
Unit 4 Corporations and Corporate Governance II
Unit 5 Board of Directors

UNIT 1 ETHICS OF JOB DISCRIMINATION

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1.0 INTRODUCTION

The debates over equality, diversity, and discrimination have been prolonged and acrimonious. Controversy continues to swirl around the nature of the plight of the inequality of women, and the harm that males have suffered as a result of preference shown to women. These continuing debates over sexual diversity have often focused on business and its needs. This is inevitable: sexual discrimination has had a long history in business, and diversity now promises to have significant benefits for business.

Perhaps more than any other contemporary social issue, public discussions of discrimination and diversity have clearly approached the subject in ethical terms: The words; justice, equality, right and discrimination inevitably find their debate. This unit analyses the various sides of this ethical issue. This unit begins by examining the nature and extent of discrimination. It then turns to discussing the ethical aspects of discriminatory behaviour in employment and ends with a discussion of diversity and affirmative action programmes.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain the distinctions companies can make between applicants without engaging in discrimination
- analyse the widespread job discrimination
- examine why it is wrong to discriminate.

3.0 MAIN CONTENT

3.1 Job Discrimination: its nature

The root meaning of the term discriminate is "to distinguish one object from another," a morally neutral and not necessarily wrongful activity. However, in modern usage, the term is not morally neutral; it is usually intended to refer to the wrongful act of distinguishing illicitly among people not on the basis of individual merit, but on the basis of prejudice or some other invidious or morally reprehensible attitude. This morally charged notion of invidious discrimination, as it applies to employment, is what the issue in this unit is.

In this sense, to discriminate in employment is to make an adverse decision (or set of decisions) against employees (or prospective employees) who belong to a certain class because of morally unjustified prejudice toward members of that class. Thus, discrimination in employment must involve three basic elements. First, it is a decision against one or more employees (or prospective employees) that is not based on individual merit, such as the ability to perform a given job, seniority, or other morally legitimate qualifications. Second, the decision derives solely or in part from sexual prejudice, false stereotypes, or some other kind of morally unjustified attitude against members of the class to which the employee belongs. Third, the decision (or set of decisions) has a harmful or negative impact on the interests of the employees, perhaps costing those jobs, promotions, or better pay.

3.2 Forms of Discrimination: Intentional and Institutional Aspects

A helpful framework for analysing different forms of discrimination can be constructed by distinguishing the extent to which a discriminatory act is intentional and isolated (or non-institutionalised) and the extent to which it is unintentional and institutionalised. First, a discriminatory act may be part of the isolated (non-institutionalised) behaviour of a single individual who intentionally and knowingly discriminates out of

personal prejudice. Second, a discriminatory act may be part of the routine behaviour of an institutionalised group, which intentionally and knowingly discriminates out of the personal prejudices of its members.

The Ku Klux Klan, for example, is an organisation that historically has intentionally institutionalised discriminatory behaviour. Third, an act of discrimination may be part of the isolated (non-institutionalised) behaviour of a single individual who unintentionally and unknowingly discriminates against someone because the individual unthinkingly adopts the traditional practices and stereotypes of the surrounding society. Fourth, a discriminatory act may be part of the systematic routine of a corporate organisation or group that unintentionally incorporates into its formal institutionalised procedures practices that discriminate against women.

The two companies examined in the ABC experiment, for example, described organisations in which the best-paying jobs are routinely assigned to men and the worst-paying jobs are routinely assigned to women on the stereotypical assumption that women are fit for some jobs and not for others. There may be no deliberate intent to discriminate, but the effect is the same: a sexually based pattern of preference toward males.

During the last century, an important shift in emphasis occurred, from seeing discrimination primarily as an intentional and individual matter, to seeing it as a systematic and not necessarily intentional feature of institutionalised corporate behaviour. During the early 1960s, employment discrimination was seen primarily as an intentional act performed by one individual on another.

3.3 Discrimination: Its Extent

How do we estimate whether an institution or a set of institutions is practising discrimination against a certain group? We do so by looking at statistical indicators of how the members of that group are distributed within the institution. *A prima facie* indication of discrimination exists when a disproportionate number of the members of a certain group hold the less desirable positions within the institutions despite their preferences and abilities. Three kinds of comparisons can provide evidence for such a distribution:

- Comparisons of the average benefits the institutions bestow on the discriminated group with the average benefits the institutions bestow on other groups.

- Comparisons of the proportion of the discriminated group found in the lowest levels of the institutions with the proportions of other groups found at those levels.

- Comparisons of the proportions of that group that holds the more advantageous position with the proportions of other groups that hold those same positions. If we look at the Nigerian society in terms of these three kinds of comparisons, it becomes clear that some form of tribal and sexual discrimination is present in the society as a whole. It is also clear that for some segments of the minority population (such as Uhrobo, Efik, Ebira, etc.) discrimination is not as intense as it once was.

3.3.1 Average Income Comparisons

Income comparisons also reveal large inequalities based on sex. A comparison of average incomes for men and women shows that women receive only a portion of what men receive. One study found that firms employing mostly men paid their workers an average 40 per cent more than those employing mostly women.

The disparities in earnings between men and women begin as soon as men and women graduate from school, contrary to the optimistic belief held by each generation of graduating women that "my generation will be different.”

3.4 Discrimination: Utility, Rights, and Justice

Given the statistics on the comparative incomes and low-status positions of women, the question we must ask ourselves is this: Are these inequalities wrong, and if so, how should they be changed? To be sure these inequalities directly contradict the fundamental principles on which Nigeria was founded: “We hold these truths to be self-evident: that all men are created equal and endowed by their creator with certain inalienable rights.” However, historically we have often tolerated large discrepancies between these ideals and reality. In some developed countries, through much of the 19th century, women could not hold office, could not vote, could not serve on juries, nor bring suit in their own names; a married woman lost control over her property (which was acquired by her husband), she was considered incapable of making binding contracts, and, in a major opinion, she was declared by the Supreme Court to have "no legal existence, separate from her husband, who was regarded as her head and representative in the social state.” Why are these forms of inequality wrong? Why is it wrong to discriminate?

The arguments mustered against discrimination generally fall into three groups

- Utilitarian arguments, which claim that discrimination leads to an inefficient use of human resources;
- Rights arguments, which claim that discrimination violates basic human rights;
- Justice arguments, which claim that discrimination results in an unjust distribution of society's benefits and burdens.

3.4.1 Sexual Harassment

Women, as noted earlier, are victims of a particularly troublesome kind of discrimination that is both overt and coercive: They are subjected to sexual harassment. Although males are also subjected to some instances of sexual harassment, it is women who are by far the most frequent victims. For all its acknowledged frequency, sexual harassment still remains difficult to define and to police and prevent.

In several major respects, the guidelines on sexual harassment are clearly morally justified. They are intended to outlaw those situations in which an employee is coerced into giving in to another employee's sexual demands by the threat of losing some significant job benefit, such as a promotion, raise, or even the job. This kind of degrading coercion exerted on employees who are vulnerable and defenseless inflicts great psychological harm on the employee, violates the employee's most basic rights to freedom and dignity, and is an outrageously unjust misuse of the unequal power that an employer can exercise over the employee. It is thus a crude violation of the moral standards of utilitarianism rights, justice, and care.

Should this kind of situation count as the kind of "intimidating, hostile or offensive working environment" that the guidelines prohibit as sexual harassment? The answer to this legal question is unclear, and different courts have taken different position on the question. But a different question and one that is more relevant to our inquiry is this: Is it morally wrong to create or allow this kind of environment? The answer to this question seems in general to be "yes" because such an environment is degrading, it is usually imposed by more powerful male parties upon more vulnerable female employees, and it imposes heavy costs on women because such environments tend to belittle them and make it more difficult for them to compete with males as equals.

Nevertheless, some critics object that these kinds of environments were not created to intentionally degrade women that they are part of the "social mores of male workers, that it is hopeless to try to change them,

and that they do not unjustly harm women because women have the power to take care of themselves. A Forbes magazine article, for example, asked rhetorically, “Can women really think they have the right to a pristine work environment free of rude behaviour?” Such sentiments are indicative of the uncertainties surrounding this issue.

SELF ASSESSMENT EXERCISE

Define the following concepts:

Job discrimination, institutional/isolated discrimination, intentional/non-intentional discrimination, statistical indicators of discrimination, utilitarian argument against discrimination, Kantian arguments against discrimination.

4.0 CONCLUSION

Earlier sections examined several future trends that will affect the future status of women and minorities in the workforce. Of particular significance is the fact that only a small proportion of new workers will be males. Most new workers will be women and minorities. Unless major changes are made to accommodate their needs and special characteristics, they will not be incorporated smoothly into the workplace

We have reviewed a number of programmes that provide special assistance to women and minorities on moral grounds. However, it should be clear, in view of the future demographic trends, that enlightened self-interest should also prompt business to give women and minorities a special hand. The costs of not assisting the coming influx of women and minorities with their special needs will not be borne entirely by women and minorities. Unfortunately, if businesses do not accommodate themselves to these new workers, businesses will not be able to find the workers they need and they will suffer recurrent and crippling shortages over the next decade. The pool of traditional male workers simply will be so small that businesses will not be able to rely on them to fill all their requirements for skilled and managerial positions.

5.0 SUMMARY

Many businesses, aware of these trends, have undertaken programmes to prepare themselves now to respond to the special needs of women and minorities. To respond to women's needs, for example, many companies have instituted day-care services and flexible working hours that allow women with children to care for their children's needs. Other companies

have instituted aggressive affirmative action programmes aimed at integrating large groups of minorities into their firms where they are provided with education, job training, skills, counseling, and other assistance designed to enable them to assimilate into the workforce. The belief of such companies is that if they act now to recruit women and minorities, they will be familiar with their special needs and will have a large cadre of women and minorities capable of bringing other women and minorities along.

6.0 TUTOR-MARKED ASSIGNMENT

Write a short note on sexual harassment as a form of discrimination.

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UNIT 2 THE INDIVIDUAL IN THE ORGANISATION

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1.0 INTRODUCTION

This unit explores individuals in the organisation and other problems raised by life within business organisations. The unit begins by describing the traditional model of the organisation: the organisation as a "rational" structure. The following sections then discuss the employee's duties to the firm as defined by this traditional model, and the employer's duties to the employee, again as defined by this model.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- examine how proponents of the rational model define a business organisation
- explain conflict of interest and how it can be avoided
- identify factors to be considered when determining fair wages.

3.0 MAIN CONTENT

3.1 The Individual in the Organisation

The individual in the organisation dwells on three main parts of an organisation which are:

- the traditional model of an organisation
- the political structure of an organisation
- the organisation as a network of personal relations.

3.2 The Rational Organisation

An organisation is the rational coordination of the activities of a number of people for the achievement of some common explicit purpose or goal, through a division of labour and function and through a hierarchy of authority and responsibility.

If the organisation is looked at in this way, then the most fundamental realities of the organisation are the formal hierarchies of authority identified in the organisational chart that represents the various official positions and lines of authority in the organisation.

At the bottom of the organisation is the "operating layer": those employees and their immediate supervisors who directly produce the goods and services that constitute the essential outputs of the organisation. Above the operating layer of labourers are ascending levels of "middle managers" who direct the units below them and who are in turn directed by those above them in ascending formal lines of authority. At the apex of the pyramid is top management: the board of directors, the chief executive officer, and the CEO's staff.

The rational model of an organisation supposes that most information is collected from the operating layers of the organisation, rises through the various formal management levels, each of which aggregates the information, until it reaches top management levels. On the basis of this information, the top managers make general policy decisions and issue general commands, which are then passed downward through the formal hierarchy, where they are amplified at each managerial level until they reach the operating layer as detailed work instructions. These decisions of the top managers are assumed to be designed to achieve some known and common economic goal, such as efficiency, productivity, profits, maximum return on investment, and so on. The goal is defined by those at the top of the hierarchy of authority, who are assumed to have a legitimate right to make this decision.

What is the glue that holds together the organisation's many layers of employees and managers and that fixes these people onto the organisation's goals and formal hierarchy? It is contractual agreement. The model conceives of the employee as an agent who freely and knowingly agreed to accept the organisation's formal authority and to pursue its goals in exchange for support in the form of a wage and fair working conditions. These contractual agreements cement each

employee into the organisation by formally defining each employee's duties and scope of authority. By virtue of this contractual agreement, the employee has a moral responsibility to obey the employer in the course of pursuing the organisation's goals, and the organisation in turn has a moral responsibility to provide the employee with the economic support it has promised.

As we have already discussed at some length, when two persons knowingly and freely agree to exchange goods or services with each other, each party to the agreement acquires a moral obligation to fulfill the terms of the contract. Utilitarian theory provides additional support for the view that the employee has an obligation to loyally pursue the goals of the firm: Businesses could not function efficiently and productively if their employees were not single-mindedly devoted to pursuing their firm's goals. If each employee were free to use the resources of the firm to pursue personal ends, chaos would ensue and everyone's utility would decline.

The basic ethical responsibilities that emerge from these "rational" aspects of the organisation focus on two reciprocal moral obligations:

- the obligation of the employee to obey organisational superiors, pursue the organisation's goals, and avoid any activities that might threaten that goal; and
- the obligation of the employer to provide the employee with a fair wage and fair working conditions. These duties in turn are presumed to be defined through the organisation's formal lines of authority and through the contracts that specify the employee's duties and working conditions. We examine these two reciprocal duties in turn.

3.3 The Employee's Obligations to the Firm

In the rational view of the firm, the employee's main moral duty is to work toward the goals of the firm and avoid any activities that might harm those goals. To be unethical, basically, is to deviate from these goals to serve one's own interests in ways that, if illegal, are counted as a form of "white-collar crime."

As administrator of the company's finances, for example, the financial manager is entrusted with its funds and has the responsibility of managing those funds in a way that will minimise risk while ensuring a suitable rate of return for the company's shareholders. Financial managers have this contractual duty to the firm and its investors because they have contracted to provide the firm with their best judgment and to exercise their authority only in the pursuit of the goals of the firm and

not for their own personal benefit. Financial managers fail in their contractual duty to the firm when they misappropriate funds, when they waste or squander funds, when they are negligent or fraudulent in the preparation of financial statements, when they issue false or misleading reports, and so on.

These traditional views of the employee's duties to the firm have made their way into the "law of agency" that is, the law that specifies the legal duties of "agents" (e.g., employees) toward their "principals" (e.g., employers). The "restatement" of the law of agency, for example, states that "an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency"; and prohibits the agent from acting "for persons whose interests conflict with those of the principal in matters in which the agent is employed." In short, the employee must pursue the goals of the firm and must do nothing that conflict with those goals while working for the firm.

There are several ways in which the employee might fail to live up to the duty to pursue the goals of the firm: The employee might act on a "conflict of interest," the employee might steal from the firm, or the employee might use the position as leverage to force illicit benefits out of others through extortion or commercial bribery.

3.4 The Firm's Duties to the Employee

The basic moral obligation that the employer has toward employees, according to the rational view of the firm, is to provide them with the compensation they have freely and knowingly agreed to receive in exchange for their services. There are two main issues related to this obligation: the fairness of wages and the fairness of employee working conditions. Both wages and working conditions are aspects of the compensation employees receive from their services, and both are related to the question of whether the employee contracted to take a job freely and knowingly. If an employee was "forced" to accept a job with inadequate wages or inadequate working conditions, then the work contract would be unfair.

3.4.1 Wages

From the employee's point of view, wages are the principal (perhaps the only) means for satisfying the basic economic needs of the worker and the worker's family. From the employer's point of view, wages are a cost of production that must be kept down lest the product be priced out of the market. Therefore, every employer faces the dilemma of setting fair wages: How can a fair balance be struck between the employer's

interests in minimising costs and the workers' interest in providing a decent living for themselves and their families?

Although there is no way to determine fair salaries with mathematical exactitude, we can at least identify a number of factors that should be taken into account in determining wages and salaries in most countries.

- **The going wage in the industry and the area:** although labour markets in an industry or an area may be manipulated or distorted (e.g., by job shortages), they generally provide at least rough indicators of fair wages if they are competitive and if we assume competitive markets are just. In addition, the cost of living in the area must be taken into account if employees are to be provided with an income adequate to their families' needs. In developing nations, employers should ensure that wages enable employees to live reasonably and to provide for their families.

- **The firm's capabilities:** in general, the higher the firm's profits, the more it can and should pay its workers; the smaller its profits, the less it can afford. Taking advantage of cheap labour in captive markets-such as those found in many developing nations-when a company is perfectly capable of paying higher wages is exploitation.

- **The nature of the job:** jobs that involve greater health risks, offer less security, require more training or experience, impose heavier physical or emotional burdens, or take greater effort should carry higher levels of compensation.

- **Minimum wage laws:** the minimum wages required by law set a floor for wages. In most circumstances, wages that fall beneath this floor are unfair. Minimum wage laws should be respected even if government does not enforce those minimums.

- **Relation to other salaries:** if the salary structure within an organisation is to be fair, workers who do roughly similar work should receive to force wage concessions out of a wholly dependent community, or when a union "blackmails" a failing company with a strike that is certain to send the firm into bankruptcy, the resulting wages have little likelihood of being fair.

- **The fairness of wage negotiations:** salaries and wages that result from "unfree" negotiations in which one side uses fraud, power, ignorance, deceit, or passion to get its way will rarely be fair. For example, when the management of a company uses the

threat of relocation. The nature of the job; jobs that involve greater health risks, offer less security, require more training or experience, impose heavier physical or emotional burdens, or take greater effort should carry higher levels of compensation.

- **Local costs of living:** the goods and services that a family needs to meet their basic needs (food, housing, clothing, transportation, child care, and education) differ from one geographical region to another. Wages should be sufficient to enable a family of four to meet their basic needs (taking into account whether families in the region are traditionally one-wage or two-wage families), even if such wages would be above the minimum wage.

3.4.2 Working Conditions: Health and Safety

Each year many workers are killed and more are injured as a result of job accidents. Ten per cent of the job force suffers a job-related injury or illness each year. Delayed occupational diseases resulting from exposure to chemical and physical hazards kill off additional numbers.

Workplace hazards include not only the more obvious categories of mechanical injury, electrocution, and burns but also extreme heat and cold, noisy machinery, rock dust, textile fiber dust, chemical fumes, mercury, lead, beryllium, arsenic, corrosives, poisons, skin irritants, and radiation.

Risk is, of course, an unavoidable part of many occupations. A race-car driver, a circus performer, and a rodeo cowboy all accept certain hazards as part of their jobs. If an employer (a) takes reasonably adequate measures both-to inform itself and the workers about workplace risks and to eliminate workplace risks, and (b) fully compensates and insures workers for assuming risks that cannot be eliminated, and (c) workers freely and knowingly accept those remaining risks in exchange for the added compensation, then we may generally conclude that the employer has acted ethically. The basic problem, however, is that in many hazardous occupations, these conditions do not obtain.

- Wages' will fail to provide a level of compensation proportional to the risks of a job when labour markets in an industry are not competitive or when markets do not register risks because the risks are not yet known. In some rural mining areas, for example, a single mining company may have a monopoly on jobs. The health risks involved in mining or using a certain mineral, such as manganese, may not be known until many years afterward. In such cases, wages will not fully compensate for risks.

- Workers might accept risks unknowingly because they do not have adequate access to information concerning those risks. Collecting information on the risks of handling certain chemicals, for example, takes a great deal of time, effort, and money. Determining the dangers of manganese, for example, took many years of studies. Therefore, workers acting individually may find it too costly to collect the information needed to assess the risks of the jobs they accept.

- Workers might accept known risks out of desperation because they lack the mobility to enter other, less risky industries or because they lack information on the alternatives available to them. Low-income manganese miners or welders, for example, may know the hazards inherent in breathing manganese vapors. However, because they lack the resources needed to look elsewhere, they may be forced to accept the job they have or starve.

When any of the three conditions obtain, the contract between employer and employee is no longer fair. The employer has a duty, in such cases, to take steps to ensure that the worker is not being unfairly manipulated into accepting a risk unknowingly, unwillingly, or without due compensation. Assuming that the employer has eliminated all workplace health and safety hazards that violate local laws and has eliminated all other hazards that can be eliminated with a reasonable investment, then:

- If any workplace health and safety risks cannot be eliminated at a reasonable cost, the employer has an obligation to fund studies of those risks, to clearly and explicitly inform workers of the risks, particularly those involving health and life, and an obligation to compensate workers for any injuries they sustain.

- Employers should offer wages that reflect the risk-premiums prevalent in other similar but competitive labour markets, so that workers are adequately compensated for the risks their jobs involve.

- To insure their workers against unknown hazards, the employer should provide them with suitable health insurance programmes and suitable disability insurance.

- Employers have an obligation (working singly or together with other firms) to collect information on the health hazards that accompany a given job and make all such information available to workers

3.4.3 Working Conditions: Job Satisfaction

The rational parts of the organisation put a high value on efficiency: All jobs and tasks are to be designed so as to achieve the organisation's goals as efficiently as possible. When efficiency is achieved through specialisation, the rational aspects of organisations tend to incorporate highly specialised jobs.

Jobs can be specialised along two dimensions. Jobs can be specialized horizontally by restricting the range of different tasks contained in the job and increasing the repetition of this narrow range of tasks.
Jobs can also be specialised vertically by restricting the range of control and decision making over the activity that the job involves. Whereas the job of the spot-welder is highly specialized vertically, the job of the plant manager is much less vertically specialised.

Job specialisation is most obvious at the operating levels of organisations. Assembly-line work usually consists of closely supervised, repetitive, and simple tasks. Low-level clerical jobs also tend to be fragmented, repetitive, dull, and closely monitored,

The debilitating effects that job specialisation can have on workers were first noted over 200 years ago by Adam Smith:

In the progress of the division of labour, the employment of the far greater part of those who live by labour, that is, of the great body of the people, comes to be confined to a few very simple operations, frequently to one or two. But the understandings of the greater part of men are necessarily formed by their ordinary employments. The man whose whole life is spent in performing a few simple operations has no occasion to exert his understanding. . He naturally loses, therefore, the habit of such exertion and generally becomes as stupid and ignorant as it is possible for a human creature to become. . It corrupts even the activity of his body, and renders him incapable of exerting his strength with vigour and perseverance, in any other employment than that to which he has been bred.

Not all workers are equally affected by job specialisation. Older workers and workers in large urban areas seem to show more tolerance for routine monotonous jobs apparently because older workers scale down their expectations over the years and urban workers reject the Puritan work ethic and prefer not to become involved in their work. Nonetheless, only 24 per cent of all blue-collar workers would choose the same type of work if they could start all over again-an indication that a substantial portion of workers do not find their jobs intrinsically satisfying.

The injuries that highly specialised work has on the well-being of workers pose an important problem of justice for employees. The most narrowly specialised forms of work are those that require the least skills (because one of the functions of specialisation is to dispense with the need for training). Unskilled labour, of course, commands the lowest levels of compensation. As a consequence, the psychological costs of dull, meaningless, and repetitive work tend to be borne by the group of workers that is paid least: unskilled labourers. Not only may the injuries of specialisation be inequitable, they are also often related to a lack of freedom. Unskilled workers often have no real freedom of choice: They must either accept work that is meaningless and debilitating or else not work at all. Therefore, the freedom that is essential to a fair work contract is often absent.

Excessive job specialisation is undesirable for other reasons than that it places unjust burdens on workers. There is also considerable evidence that it does not contribute to efficiency. Research findings have demonstrated that there is a linkage between worker productivity and programmes that improve the quality of work life for workers by giving workers greater involvement in and control over a variety of work tasks

How should these problems of job dissatisfaction and mental injury be dealt with? Hackman, Oldham, Jansen, and Purdy have argued that there are three determinants of job satisfaction.

- Experienced meaningfulness: the individual must perceive his work as worthwhile or important by some system of values he accepts.
- Experienced responsibility: he must believe that he is personally accountable for the outcome of his efforts.
- Knowledge of results: he must be able to determine, on some regular basis, whether the outcomes of his work are satisfactory.

To influence these three determinants, jobs must be expanded along five dimensions.

- **Skill variety:** the degree to which a job requires the worker to perform activities that challenge his skills and abilities.
- **Task identity:** the degree to which the job requires a completion of a whole and identifiable piece of work-doing a job from beginning to end with a visible outcome.
- **Task significance:** the degree to which the job has a substantial and perceivable impact on lives of other people, whether in the immediate organisation or the world at large.
- **Autonomy:** the degree to which the job gives the worker freedom, independence, and discretion in scheduling work and

determining how he will carry it out.

- **Feedback:** the degree to which a worker, in carrying out the work activities required by the job, gets information about the effectiveness of his efforts.

In short, the solution to job dissatisfaction is perceivable enlargement of the narrowly specialised jobs that give rise to dissatisfaction: broadening the job “horizontally” by giving the employee a wider variety of tasks and deepening the job “vertically” by allowing the employee more perceivable control over these tasks. For example, jobs can be horizontally enlarged by replacing single workers performing single repetitive tasks with teams of three or four who are jointly responsible for the complete assembly of a certain number of machines. Such team jobs can be vertically enlarged by delegating to the team the responsibility of determining their own work assignments, work breaks, and inspection procedures.

3.5 Employee’s Rights

Observers of corporations have repeatedly pointed out that the power of modern corporate management is much like that of a government. Governments are defined in terms of four features: (a) a centralised decision-making body of officials who (b) have the power and recognised authority to enforce their decisions on subordinates (citizens); these officials (c) make decisions that determine the public distribution of social resources, benefits, and burdens among their subordinates, and (d) they have a monopoly on the power to which their subordinates are subject. These same four features, observers have argued, also characterise the managerial hierarchies that run large corporations.

(a) Like a city, state, or federal government, the top managers of a corporation constitute a centralised decision-making body;
(b) These managers wield power and legally recognised authority over their employees-a power that is based on their ability to fire, demote, or promote employees and an authority that is based on the law of agency that stands ready to recognise and enforce managerial decisions;
(c) The decisions of managers determine the distribution of income, status, and freedom among the corporation's constituencies; and
(d) Through the law of agency and contract, through their access to government agencies, and through the economic leverage they possess, managers of large corporations effectively share in the monopoly on power that political governments possess.

These analogies between governments and managements, several observers have held, show that the power managers have over their

employees is fully comparable to the power government officials have over their citizens. Consequently, if there are moral limits to the power government officials may legitimately exercise over citizens, then there are similar moral limits that should constrain the power of managers. In particular, just as the power of government should respect the civil rights of citizens, so the power of managers must respect the moral rights of employees. What are these employee rights? The moral rights of employees would be similar to the civil rights of citizens: the right to privacy, the right to consent, the right to freedom of speech, and so on.

The major objection to this view of employee rights is that there are a number of important differences between the power of corporate managers and the power of government officials, and these differences undercut the argument that the power of managers should be limited by employee rights comparable to the civil rights that limit the power of government.

First, the power of government officials (in theory at least) is based on consent, whereas the power of corporate managers is (in theory again) based on ownership. Government officials rule because they have been elected or because they have been appointed by someone who has been elected; corporate managers *rule* (if that is the right word) because they own the firm for which workers freely choose to work or because they have been appointed by the owners of the firm. Consequently, because the power of government rests on the consent of the governed, that power can legitimately be limited when the governed choose to limit it. However, because the power of managers rests on ownership of the firm, they have the right to impose whatever conditions they choose to impose on employees, who freely and knowingly contracted to work on their firm's premises.

Second, the power of corporate managers, unlike that of most government officials, is effectively limited by unions: Most blue-collar and some white-collar workers belong to a union that provides them with a degree of countervailing power that limits the power of management. Accordingly, moral rights need not be invoked to protect the interests of employees.

Third a citizen can escape the power of a particular government only at great cost (by changing citizenship), an employee can escape the owner of a particular management with considerable ease (by changing jobs). Because of the relatively high costs of changing citizenship, citizens need civil rights that can insulate them from the inescapable power of government. They do not need similar employee rights to protect them from the power of a corporation whose influence is easily escaped.

Advocates of employee rights have responded to these three objections in a number of ways: First, they claim, corporate assets are no longer controlled by private owners; they are now held by a dispersed and almost powerless group of stockholders. This kind of dispersed ownership implies that managers no longer function as agents of the firm's owners and, consequently, that their power no longer rests on property rights. Second, although some workers are unionised, many are not, and these non unionised workers have moral rights that managers do not always respect. Third, changing jobs is sometimes as difficult and traumatic as changing citizenship, especially for the employee who has acquired specialised skills that can be used only within a specific organisation.

There is, then, a continuing controversy over the adequacy of the general argument that, because managements are like governments, the same civil rights that protect citizens must also protect employees. Regardless of whether this general argument is accepted, a number of independent arguments have been advanced to show that employees have certain particular rights that managers should respect.

SELF ASSESSMENT EXERCISE

Outline the employee's obligation to the firm

4.0 CONCLUSION

An organisation is the co-ordination of the activities of a number of people for the achievement of some common explicit purpose or goal, through a division of labour and function and through a hierarchy of authority and responsibility.

5.0 SUMMARY

As employees have certain duties to the organisation, employers/organisations also hold certain duties to the employees; some are expressed while some are implied, all these must be balanced against ethics.

6.0 TUTOR-MARKED ASSIGNMENT

1. Outline the responsibilities of the firm to its employees
2. Is the paying of wages a priviledge or a tight of the employees? Explain your answer.

7.0 REFERENCES/FURTHER READING

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UNIT 3 CORPORATIONS AND CORPORATE GOVERNANCE I

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1.0 INTRODUCTION

Capitalism is an economic system of business based on private enterprise. Individuals and businesses own land, farms, factories, and equipment, and they use those assets to earn profits. Capitalism is a good economic system because it can provide rewards for those who work hard and who are inventive and creative enough to figure out new or improved products and services. One potential reward for creating value in an economy is the accumulation of personal wealth. The wealth incentive provides the fuel to generate new ideas and to foster economic value that provides jobs and raises our standard of living.

The main goal of a company is to create an environment conducive to earning long-term profits, which stem from two main sources: First, a business must provide products and/or services to a customer base. A large portion of a firm's value derives from the current and future profits

of its business activity. Finding ways to increase profits from core operations can increase economic value. Second, increased profits can come from growth in the sales of an existing product or sales resulting from the introduction of a new product

Expansion usually requires additional money, or capital. Business activities also entail risk. The abilities to access capital and to control risk are important in the success or failure of a firm. Such abilities are influenced by the manner in which a firm is organised. In this unit, we will define corporate governance and give a brief historical perspective of corporate governance in Nigeria. We will also describe different forms of business, with emphasis on the corporation. We will then describe the people involved in the corporate form of business, and the separation of owners and managers that this entails. This separation is problematic, but we will describe how corporate governance can address this problem.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- describe forms of business ownership
- identify the differences between business ownership and business control
- explain investors' influence on managers
- define an integrated system of governance.

3.0 MAIN CONTENT

3.1 Definition and Meaning of Corporate Governance

Corporate governance refers to the broad range of policy and practices that stockholders, executive managers, and boards of directors' use to (1) manage themselves and (2) fulfill their responsibilities to investors and other shareholders. Over the past decade, corporate governance has the subject of increasing the stakeholder and attention and scrutiny. These concerns have given rise to a powerful shareholder movement.

Shareholder activists, composed primarily of large multi-billion-naira pension funds, religious groups, socially responsible investment groups, and other institution investors, are now using a variety of vehicle to influence board behaviour, including creating corporate governance standard of excellence and filling shareholders resolution. These investors are concerned with such topics as board diversity, independence, compensation, and accountability, as well as broad range

of social issue, e.g. employment, ethnic practices, environmental policies, and community involvement.

Corporate governance can also be defined as a set of mechanisms, through which “outside” investors are protected from expropriations by insiders of their companies. Insiders include managers, major shareholders (individuals, corporate investors, family interest and/or governance) as well as large creditors (e.g. banks). Outsider includes equity investors, provider of debt and minority shareholders.

Expropriation of outsiders takes the forms of outright theft of assets, transfers pricing, excessive executive compensation, entrenchment of inept management teams, diversion of funds to unsuitable projects that benefit one group of insiders etc. The role of corporate governance is therefore to prevent the expropriation of investors by managers, smaller investors by larger ones and debt provided by equity investors or vise versa. In practice, protection mechanisms are limited as a legal protection depends on enforcement and quality of law in the country where the business is located while ownership concentrations leave the minority exposed to expropriation by larger shareholders. Most corporate governance systems therefore rely on a combination of legal enforcement and ownership concentration and, sometime the threat of hostile takeover through an active market, for corporate control.

The key issues in evaluating a corporate governance system are trust worthy accounting and disclosure system which provide a mean for investors to monitor their investment by accessing information, legal protection for investor’s right, effective board and an active market for corporate control.

3.2 Forms of Business Ownership

In general, a business can be a sole proprietorship, a partnership, or a corporation. Other forms exist, but we will focus on these three as this is the most general distinction. Each organisational form involves different advantages and disadvantages. A sole proprietorship is a business owned by a single person. These businesses are relatively easy to start up and business tax is computed at the personal level. Due to its simplicity, sole proprietorships are ubiquitous, representing more than 70 percent of all businesses. However, there are several significant drawbacks. Such firms often have a limited lifespan (they die with the owner's death or retirement), they have a limited ability to obtain capital, and the owner bears unlimited personal liability for the firm.

A partnership is similar to a sole proprietorship but there is more than one owner. As such, a partnership shares the advantages and

disadvantages of the sole proprietorship. While one obvious advantage of a partnership is the ability to pool capital, this advantage may not be as important as combining service oriented expertise and skill, especially for larger partnerships. Examples of such partnerships include; accounting firms, law firms, investment banks, and advertising firms.

This unit focuses on the third business form, the corporation. Fewer than 20 per cent of all businesses are corporations but they generate approximately 90 percent of the country's business revenue. The corporation is its own legal entity, as if it were a person. For example, the corporation can engage in business transactions and other business activities in its own name. Corporate officers act as agents for the firm and authorise those activities.

Perhaps the most important advantage of the corporate business form is access to capital markets. Public companies can raise money by issuing stocks and bonds to investors while sole proprietorships and partnerships may access millions of naira through the business owners' wealth and banks corporations may be able to access billions of naira. Access to this capital causes entrepreneurs such as Bill Gates of Microsoft, Steve Jobs of Apple, Larry Ellison of Oracle and Aliko Dangote of Dangote Plc to take their companies the public so that their businesses can become corporations. To raise money for expansion in the capital markets, the business sells stock to investors.

For example, between 1977 and 1980, Apple Computer sold a total of 121,000 computers. To meet the potential demand for millions of computers per year, Apple needed to expand operations significantly. As a result, in 1980, Apple became a public corporation. Dangote also, gave up a great deal of ownership to new investors in exchange for the capital to expand the firm. (Incidentally, as we will describe later, this decision would later come back to haunt Dangote).

Stockholders or shareholders are the owners of a public corporation. These shareholders receive any value that is created by the firm, but they can also lose their investments if the firm goes bankrupt. The process has two benefits. First, any individual, as long as she has some money, can invest in business and increase her wealth over the long term. Second, businesses with growth potential can obtain the capital needed to expand, which creates economic value, jobs, and taxes. A corporation has an infinite life, unless terminated by bankruptcy or merger with another firm. The owners of corporations enjoy limited financial liability because they can lose only, at most, the value of their ownership shares. Further, corporate ownership is usually liquid, and

ownership stakes can be easily bought and sold as stocks in a marketplace, such as the Nigeria stock exchange.

The advantages of the corporate business form are appealing, but there are also major disadvantages. Corporate profits are subject to business taxes before any income goes to shareholders in the form of dividends. Subsequently, shareholders must also pay personal taxes on dividend income. Therefore, shareholders are exposed to double taxation. In addition, running a corporation can be expensive. For example, the costs of hiring accountants and legal experts, the costs of communicating with all shareholders, the costs of complying with regulations, and so forth can cost millions of naira per year. Finally, and perhaps the most important disadvantage, corporations suffer from potentially serious governance problems. Most investors only own a small stake of a large public corporation, so they consequently do not feel any true sense of ownership or control over the firms in which they own stock.

3.3 Investors and Managers

Theoretically, managers work for owners (shareholders). In reality, because shareholders are usually inactive, the firm actually seems to belong to management. Some active shareholders have tried to influence management, but they are often met with defeat. Recent evidence of unsuccessful outcomes of shareholder proposals is quite telling. Shareholders have the power to make proposals that can be voted on at the annual shareholders meeting. There are generally two types of proposals, those related to governance (e.g. suggesting changes in board structure) and those oriented to social reform (e.g. proposing to stop selling chemicals to rogue countries). About half of all shareholder-initiated proposals progress far enough in the process to reach the voting stage. When there is a vote, such proposals usually are defeated.

A huge factor in whether a proposal is successful depends on management's opinion. Without management approval, proposals have little chance of succeeding. Traditionally, shareholders have trusted management to know what is best for the firm. Most shareholders will go along with whatever management wants.

3.3.1 Monitoring of Investments

Generally speaking, the investing public does not know what goes on at the firm's operational level. Managers handle day-to-day operations, and they know that their work is mostly unknown to investors. Consequently, managers may not act in the shareholder's best interest, which demonstrates the need for monitors.

Outsiders including auditors, analysts, investment banks, credit rating agencies, and outside legal counsel all interact with the firm and monitor manager activities. Auditors examine the firm's accounting systems and comment on whether financial statements fairly represent the financial position of the firm. Investors and other stakeholders use the public financial statements to make decisions about the firm's financial health, prospects, performance, and value. Even though investors may not have the ability or opportunity to validate the firm's activities, accountants and auditors can attest to the firm's financial health and verify its activities.

Investment analysts who follow a firm conduct their own, independent evaluations of the company's business activities and report their findings to the investment community. Analysts are supposed to give unbiased and expert assessments. Investment banks also interact with management by helping firms access the capital markets. When obtaining more capital from public investors, firms must register documents with regulators that show potential investors the condition of the firm. Investment banks help firms with this process and advise managers on how to interact with the capital markets

The government also monitors business activities through the Securities and Exchange Commission (SEC) and the Internal Revenue Service (IRS). The SEC regulates public firms for the protection of public investors, and it makes policy and prosecutes violators in civil courts.

The IRS enforces the tax rules to ensure corporations pay taxes, just as it does with individual citizens.

Market forces can also help discipline management. If a manager is not doing a good job, either because he is bad at managing or because he is abusing his managerial discretion, then his firm might get taken over and he is subsequently fired. In this sense, the fear of a potential takeover might represent a powerful disciplinary mechanism to make sure that managers perform to the best of their abilities and to make sure that managerial discretion is controlled.

Stakeholders also monitor the firm. Some stockholders, such as large institutional investors like pension funds, are active monitors. Creditors will make sure the firm can handle its debt. Employees, such as internal auditors, might monitor the firm to make sure it is healthy. And society could instill a sense of corporate citizenship to the firm so that firm executives feel a sense of responsibility toward their community.

As a group, this is a pretty impressive set of monitors. Unfortunately, all of the mechanisms can fail at one time or another. An important purpose

of this unit is to describe each of these corporate monitors and the problems that may exist with each of them.

3.4 An Integrated System of Governance

The corporate governance system is integrated and complicated. The potential incentives for executives, auditors, boards, banks, and so on, to misbehave are intertwined. By focusing on one part of the system, students might not fully understand how the governance system can break down.

Analysts talk to management to gauge the prospects of the firm. Managers want to paint a rosy picture so that analysts will recommend a "buy" rating and the stock price will rise. However, this situation may also cause analysts to predict a high profit forecast for the company, and the managers may struggle to meet the high forecast. If the business activities of the firm do not merit the high profit forecast, managers might then pressure their accounting department to help. In some cases, consultants are hired who recommend aggressive accounting techniques to help show increased profits.

The public auditors for the firm may have had a long and fruitful relationship with the company, auditing the books for many years. The auditors are proud to have a prestigious corporation as a client and do not want to end this relationship; consequently they may not press too hard on limiting aggressive accounting methods. Why are managers so obsessed with pushing hard for smooth and increasing profits? Why are they obsessed with gaining analyst favour? It is because a board (which is largely picked by the managers) awards them stock options and stock incentives. If managers can increase the price of the stock, then they can cash in their options and stock and become rich.

Regulators also monitor managers' behaviour. However, regulators often have experience as partners in consulting firms, auditing firms, or law firms that are an integral part of the system. By participating in the corporate system, regulators know how it works. Unfortunately, they might also have their own conflicts of interest.

This unit describes the following monitors or monitoring mechanisms.

- Incentive contracts that supposedly align executive incentives with shareholder interests;
- Accountants and auditors who check the firm's financial statements;
- Boards of directors who represent shareholders;

- Investment banks and analysts that brings securities to the public for sale and evaluates them;
- Creditors and credit rating agencies who monitor the firm's ability to handle debt;
- Shareholders themselves;
- The corporate takeover market where supposedly good firms take over bad firms;
- The Securities and Exchange Commission who are the official regulators of the securities industry; new governance laws; and
- Corporate citizenship that should instill a sense of corporate responsibility to the executives.

3.5 Reasons for Corporate Governance

The following reasons have been identified for instituting and implementing corporate governance in Nigerian corporate world.

- To reduce conflict of interests between Board and Management resulting in board squabbles.
- To address ineffective board oversight functions.
- To eliminate or reduce fraudulent and self-serving practices among members of the board, managements and staffs.
- To reduce over bearing influence of chairman or MD/CEO, especially in family controlled businesses.
- To ensure compliance with laid-down internal control and operation procedures.
- To remove the problem of sit tight directors even where such directors fail to make meaning full contributions to the growth and development of the firm.
- To prevent succumbing to pressure from other stakeholders e.g. shareholder's appetite for high dividend.
- To forestall inability to plan and respond to changing business circumstances.
- To bring about an effective management information system.
- To put an end to insider trading.

3.6 Executive Incentives

3.6.1 Potential Managerial Temptations

A manager has a variety of stakeholders that are affected by his actions. These include investors such as stockholders (owners) and lenders, the firm's customers and suppliers, the firm's employees, and of course himself. A good manager should put the needs of other stakeholders

before his own but human nature may cause him to put his needs first. Examples of self-serving managerial actions include:

- shirking (i.e. not working hard);
- hiring friends;
- consuming excessive perks (e.g. purchasing extravagant office furniture using company cars, enjoying large expense accounts);
- building empires (i.e. making the firm as large as possible even, though it may hurt the firm's per share value);
- taking no risks or chances to avoid being fired; and
- having a short-run horizon if the manager is near retirement.

One way to make sure that managers will not behave in these ways is to give them the right monetary incentives to act in the interests of their other stakeholders. We discuss various types of executive compensation that are aimed at accomplishing this task.

3.6.2 Types of Executive Compensation

Company executives are compensated in many different ways. They receive a basic salary that also includes pension contributions and perquisites (company car, club memberships, and so on). In addition, top executives might receive a bonus that is usually linked to accounting-based performance measures. Lastly, managers might receive additional wealth through long-term incentive programmes, usually in the form of stock options, which reward the manager for increasing the company's stock price. Stock grants are another common form of long-term awards.

3.6.2.1 Basic Salary and Bonus

As with most jobs, CEOs are promised a specific annual salary. The base salary of a company CEO is often determined through the benchmarking method, which surveys peer CEO salaries for comparison. Salaries less than the 50th percentile are considered under market, while salaries. In the 50th to 75th percentile are competitive. CEO base salary has continuously drifted upward because CEOs typically argue for competitive salaries. So each year, we often see CEOs getting nice raises and also we see new CEOs making more than current CEOs. Interestingly, this basic pay results more from characteristics of the firm (e.g. industry, size) than on characteristics of the CEO (e.g. age, experience). So a CEO of a large firm often gets a salary higher than a CEO of a smaller firm, regardless of the person's past success, age, and experience.

At the end of every year, CEOs often receive cash bonuses. The size of the payment is based on the performance of the firm over the past year

and is typically based on the accounting profit measurements of earnings per share (EPS) and earnings before interest and taxes (EBIT). Measures of economic value added (or EVA) are also common. These value-added measures are usually variations on earnings minus the cost of capital. The idea is to measure the value added to the firm in relation to the firm's costs of using different sources of money to conduct its business activities.

Whether EBIT or EVA is used, a low threshold needs to be reached in order to qualify the CEO for a bonus. Higher levels of firm performance merit higher bonus amounts up to a specific maximum or cap. An advantage of awarding bonuses, as opposed to giving large raises, is that bonuses are one-time rewards for past realised performance, while raises are permanent additions to salaries for future unrealised performance. For these reasons, bonuses are a popular component of the overall compensation package.

3.6.2.2 Stock Options

Executive stock options are the most common form of market-oriented incentive pay. Stock options are contracts that allow executives to buy shares of stock at a fixed price, called the exercise or strike price. Therefore, if the price of the stock rises above the strike price, the executive will capture the difference as a profit. For example, if the stock of a company trades at ₦50 per share, the CEO may be given options with a strike price at ₦50. Over the next few years, if the stock price rises to ₦75 per share, then shareholders would receive a 50 per cent return on their stock holdings. The CEO could buy stock for ₦50 per share by exercising the option and sell it for ₦75 per share, thus making a ₦25 profit on each option owned. If the executive has options for 1 million shares, then he could pocket ₦25 million. If the stock price reaches ₦100 per share, the executive could cash in for ₦50 million. In contrast, if the stock price were to drop to less than ₦50 per share, then the options have no exercisable value and are said to be underwater. Executives treat stock options as compensation; they nearly always exercise the options to buy the stock and then sell the stock for the cash. Only rarely will an executive keep the stock.

Stock options give the executives of the firm the incentive to manage the firm in such a way that the stock price increases, which is precisely what the stockholders want as well. Therefore, stock options are believed to align managers' goals with shareholders' goals. This alignment helps to overcome some of the problems with the separation of ownership and control. The typical executive option contract assigns the strike price of the options to the prevailing stock price when the option is granted. The most common length of the options contract is 10 years. That is, the

CEO has 10 years to increase the price of the stock and exercise the options. After 10 years the options expire. Executives cannot sell or transfer their options and are discouraged from hedging the stock price risk.

3.6.2.3 Stock Grants

Because of the perception that executive options may have contributed to the governance failures in the late 1990s and early 2000s, many companies have been looking for alternative forms of long-term incentive compensation. Two types have gained in popularity; restricted stock grants and performance shares.

3.6.2.4 Restricted Stock

Restricted stock is common stock of the company that includes a limitation that requires a certain length of time to pass or a certain goal to be achieved before the stock can be sold. Executives may receive a grant of shares that require 10 years to pass before the executive may sell them. Restricted stock has an advantage over options in that its value does not go to zero when the stock price falls. Therefore, it does not have the asymmetric incentives that options cause. (Options are asymmetric because their exercisable value could end up being worth a lot or worth nothing).

3.6.2.5 Performance Shares

Performance shares refer to a company's stock given to executives only if certain performance criteria are met, such as earnings per share targets. In one sense, these shares could be viewed as bonuses for past realised performance. If the firm's stock price has increased, then these performance shares are more valuable to the CEO when he receives them.

3.7 Does Incentive-Based Compensation Work in General?

There are two ways to examine whether or not incentive-based compensation works. First, one could try to see if there is a positive relation between firm performance and management compensation. This would be defined as *expost* evidence. In other words, have managers been properly rewarded for increasing the firms' value? If the answer is yes, then we could surmise that incentive compensation works. Professors Michael Jensen and Kevin Murphy provide the most well-known evidence that the answer is pretty much "no." They examined the total compensation of over 2,000 CEOs and they found that when the value of the firm increased by $1,000, then those CEOs were paid

$3.25 more on average. Imagine a CEO who takes over a large firm. This CEO would have to increase the firm's value by over $300 million to increase their compensation by a mere $1 million. In academic jargon, we would say that the pay-for-performance sensitivity is very low.

Another way to assess the efficacy of incentive-based compensation is to see if those firms that enacted these compensation mechanisms subsequently experienced superior performance. This could be defined as *ex ante* evidence. In other words, once managers are given incentives, then did the firms subsequently perform well? Intuitively, we might expect the answer to be "yes" but surprisingly the evidence is mixed. Perhaps some managers are risk-averse. Their salaries are already large so why should they take risks? Or if a firm relies heavily on executive stock option incentives, then perhaps those managers are excessive risk-takers where the risk sometimes pays off and sometimes it does not. In addition, note that it is difficult to relate firm performance to management compensation contracts. If firms perform well, how can we be reliably sure that the incentive-based compensation contract had anything to do with the firm's success?

3.8 Other Compensation

Executives often receive other forms of compensation that are sometimes not reported to the SEC on official documents. The old style perk of a company paying for a CEO's club membership may come to mind but that is passé compared to modern perks. The company will frequently pay for financial advisors, luxury cars and chauffeurs, personal travel, Manhattan apartments, and more.

Another benefit is obtaining a company loan. Executives commonly borrow. Hundreds of thousands or even millions of naira at extremely low interest rates, sometimes even interest free.

3.9 Crime and Punishment

Earlier, we stated that managers will work hard on behalf of shareholders if they are carefully monitored and if they have the right incentives. Most of this course discusses monitoring. This unit has discussed managerial incentives. However, perhaps a third way to align the incentives of mangers with shareholders is to increase the penalty for mangers that intentionally and knowingly mislead and behave in ways that are not beneficial to the shareholders.

Will punishment serve to deter managerial misbehaviour? Time will tell. But it is often the case that “carrots” or rewards are better motivators than “sticks” or punishment.

SELF ASSESSMENT EXERCISE

a. How can executive compensation align manager interests with shareholders’ interests?
b. Why is governance necessary?

4.0 CONCLUSION

To understand Corporations and Corporate Governance, you must first of all understand the various types of business organisations that exist, which include sole proprietorship; partnership and corporation, which corporate governance is more concerned with.

5.0 SUMMARY

The corporate form of business allows firms that need capital to obtain it and expand, thereby helping the economy. This form also allows people with money to provide those funds and profit from having ownership in business. The disadvantage of public corporations lies in the relation between ownership and control. Managers who control the firm can take advantage of the investors who own the firm.

To inhibit poor managerial behaviour, shareholders try to align the executives' interests with their own interests through incentive programmes involving stock and stock options. In addition, the corporate system has several different groups of people that monitor managers. Unfortunately, both alignment incentives and monitoring groups bring to the table their own set of problems. The corporate system has interrelated incentives that combine to create an environment where people might act unethically.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the three basic forms of business ownership? What are the advantages and disadvantages of each?
2. Name and describe the different groups that monitor a firm.

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UNIT 4 CORPORATIONS AND CORPORATE GOVERNANCE II

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
  3.1 Accountants and Auditors
    3.1.1 Accounting Functions
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    3.1.3 Accounting for Outside Use
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1.0 INTRODUCTION

Accountants and auditors are important parts of any corporate monitoring system. Accountants keep track of the quantitative financial information of the firm. Because mistakes and other problems (such as intentional fraud) may occur with accounting, there are auditors that review the financial information. As such, auditors may be in the best position to monitor companies. In this process, auditors obtain private information about the company that others cannot obtain, and they use this information to determine whether the company's public financial statements reflect the true level of business being conducted. Banks, creditors, and others rely on these statements to get an accurate picture of the firm's business activities and financial health. Investors use these public statements to assess the value of the company. Therefore, the auditors' candid evaluation of those statements is crucial. This chapter first provides an overview of accounting and auditing. Then it discusses how accountants and auditors might contribute to financial fraud and how they might expose fraud.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- outline accounting functions
- explain auditing
- describe accounting oversight.

3.0 MAIN CONTENT

3.1 Accountants and Auditors

3.1.1 Accounting Functions

Historically, accounting has been the function of gathering, compiling, reporting, and archiving a firm's business activities. This accounting information helps individuals in many roles who depend on it to make decisions. For convenience, those who need accounting information are categorised as either insiders or outsiders of the firm.

3.1.2 Accounting for Inside Use

Management accounting is the development of information for insiders, such as company managers. Managers use this information to measure the progress toward their goals and highlight any potential problems in advance. For example, managers want to know which products have the best sales and which are selling poorly. Which products tend to sell together? How is inventory being managed? What about cash? Will the firm have enough cash to pay its upcoming debt payments?

Accountants answer these questions with budgets, variance reports, sensitivity analysis, revenue reports, cost projections, and even analysis of competitors. When firms consider how to expand products and services, managerial accountants help formulate profit projections from revenue and cost projections. In short, managerial accounting has historically played a large part in the control and evaluation of the business and its performance.

3.1.3 Accounting for Outside Use

Outsiders of the firm also use accounting information. Investors, banks, the government, and other stakeholders have a keen interest in the financial health of the firm. Banks and other creditors want to know if the firm will be able to pay its debts. Shareholders want to know how

profitable the firm is and how profitable it may be in the future. Employees might have a double interest because they have their careers and employment at stake and they might be investors through their retirement plans as well.

Financial accounting provides information for outsiders. Whereas managerial accounting reports may break down performance for managers by individual products or regions of the country, financial reports summarise the business as a whole, although they can be broken into business segments and regions. In the case of publicly held companies, these reports are the quarterly and annual financial statements that they must file with the Securities and Exchange Commission (SEC).

The three main **financial statements** (income statement, balance sheet, and statement of cash flows) and other pieces of important information (e.g. popular press articles and analyst recommendations) are used by outsiders to determine the firm's value, profits, and its risk. Outsiders want to be able to compare firms easily. These statements are prepared by the accountants of the firm and reviewed by independent accountants from an auditing firm (more on auditors later in the unit).

The Internal Revenue Service (IRS) also requires accounting information for tax purposes. The accountants of the firm report profits or losses to the IRS and determine the tax liability. Interestingly, accounting methods and business record-keeping can be very different for reports to managers, for public financial statements and for the IRS. When reporting business activities in an annual report, choices are made that maximise earnings in order to make them appear stronger than they would otherwise be, in the hope of driving up the firm's stock price. When IRS forms are being completed, choices are made to minimise earnings in order to minimise tax expenditures.

3.2 Problems that May Occur in Accounting

As with any kind of record-keeping, there are potential problems. First, unintentional errors are possible. Sometimes these errors are due to miscalculations or due to applying an expense to the wrong accounting ledger. Another potential problem occurs when judgments are required. Should firms count all receivables when they know that some clients and customers might never pay for goods or services rendered? Finally, accountants could perpetuate fraud. For example, they could overstate income, understate liabilities, or overstate assets such as receivables. Or they could be tricked by a manager to inadvertently commit fraud on his behalf. Accounting fraud is probably the largest potential problem with accounting, as it is intentional (either by a manager or by an accountant)

and hurts the firm's stakeholders, including its shareholders. Because of these potential accounting problems, the role of auditors is important, which we will discuss next.

3.3 Auditing

Auditing can be defined as the independent examination of and an expression of opinion on the financial statements of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with any relevant statutory obligation. Within the content of this course, we shall be treating both internal and external auditors and their roles.

3.3.1 Internal Auditors

Many firms have internal auditors. Their responsibility is to oversee the firm's financial and operating procedures, to check the accuracy of the financial recordkeeping, to implement improvements with internal control, to ensure compliance with accounting regulations, and to detect fraud. Firms are not required to have internal auditors but many firms have them to enhance their accounting and internal control efficiency. In fact, the people who initially detected financial fraud at World Com were the company's own internal auditors.

3.3.2 External Auditors

External auditors are accountants from outside the firm, who review the firm's financial statements and its procedures for producing them. Their job is to attest to the fairness of the statements and that they materially represent the condition of the firm. Often the external auditor will assess the system and procedures used by internal auditors to see if they can rely on the internally-generated reports when conducting their own audit. To conduct their external audit, the auditors might:

- conduct interviews with the firm's employees to assess the quality of the internal audit system.
- make their own observations of the firm's assets such as inventory levels;
- check sample balance-sheet transactions.
- confirm with the firm's customers and clients to check the accuracy of short term assets and liabilities; and
- conduct their own financial statements analysis such as comparing the firm's financial ratios from one period to the next. Once they have completed their audit, they will generate a report.

Because external auditors are supposed to be independent of the firm being audited and because their explicit job is to check for financial mis-

statements, it is they who must ensure the accuracy of the firm's financial information for shareholders.

Because of this legislative requirement, in the late 1930s and 1940s accounting firms flourished with the increased demand for auditing services. Initially the high demand resulted from the new laws that required independent verification of a firm's financial books. The demand for auditing services continued to grow as the economy eventually picked up and the number of public firms increased. There was plenty of business for auditing firms and the environment was such that they could play an effective role as independent monitors-even becoming adversarial with the firm if necessary.

In the 1970s and 1980s, however, the auditing business began to change. The number of new companies that needed auditing services was no longer expanding. If auditing firms wanted to grow, they had to steal clients away from other auditing firms. The code of ethics was changed to permit advertising and other competitive practices. Auditing firms began to advertise and cut their prices to lure new clients. The relationship between the auditing firm and the audited company also began to change; with other audit firms courting them and corporate managers no longer tolerating adversarial auditors. Auditors became friendlier in order to keep their clients, especially the larger companies. Because of the prestige associated with having Fortune 500 companies as clients, auditing firms became less confrontational in order to keep them as clients. During this period, auditing firms also developed consulting services to advise companies on how to improve their accounting methods and business activities. This provided both another source of income for accounting firms and a way to solidify their relationships with company management.

SELF ASSESSMENT EXERCISE

1. What is the role of management accounting, financial accounting, internal auditing, and external auditing?
2. What has weakened the ability of external auditors to conduct objective audits?

4.0 CONCLUSION

Accountants keep track of the firm's financial records. Internal and external auditors review these records. Therefore auditors are an important part of the governance system.

5.0 SUMMARY

The role of accounting has changed in recent years. Aside from keeping financial records, they are asked to manage earnings to meet internal and external targets, to window dress the firm's financial statements, and to smooth reported income from year to year. Sometimes when accountants "work the numbers," they are treading a dangerous line between manipulating figures within the rules and outright fraud. Auditors might be fooled by the accounting trick, which weakens their ability to detect errors. Further, auditors might even be tempted to participate in this dangerous treading. They want clients to be happy and they are subject to a possible conflict of interest problem if they are also the firm's consultants.

6.0 TUTOR-MARKED ASSIGNMENT

1. Outline the problems that may occur in accounting
2. How is accounting useful within a firm?

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UNIT 5 BOARD OF DIRECTORS

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1.0 Introduction
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  3.1 An Overview of Boards
    3.1.1 The Board's Legal Duties
    3.1.2 Board Committees
  3.2 Who is a Director?
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1.0 INTRODUCTION

Generally, a board of directors is charged with the following five broad functions:

- to hire, evaluate, and perhaps even fire top management, with the position of CEO being the most important to consider;
- to vote on major operating proposals (e.g. large capital expenditures and acquisitions);
- to vote on major financial decisions (e.g. issuance of stocks and bonds, dividend payments, and stock repurchases);
- to offer expert advice to management; and
- to make sure the firm's activities and financial condition are accurately reported to its shareholders.

In executing all of the above functions, directors are supposed to represent the interests of the shareholders. Therefore the board provides an important corporate governance function. Because the board is a part of the firm's organisational structure at the top of the corporate hierarchy it might be considered the firm's most important internal monitor.

While the board's role in the corporation seems to ensure that shareholder interests are being attended to, there are some potentially serious problems. Among the issues are a lack of board independence from the CEO, directors who do not have the time or expertise to fulfill their roles adequately, and members who do not have a vested interest in

the firm. This chapter provides an overview of corporate boards and their role in corporate governance and it also highlights potential problems with many of today's boards.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define the board and directors
- identify the duties and responsibilities of a director
- outline the various board committees.

3.0 MAIN CONTENT

3.1 An Overview of Boards

3.1.1 The Board's Legal Duties

State laws vary from one state to the other but fortunately every state requires that a corporation have a board of directors.

Further, all state laws abide by a concept known as the business judgment rule. Specifically, directors must act in good faith and with sincere belief that their actions are in the corporation's and shareholders' best interests. In order to abide by the spirit of this rule, directors have certain responsibilities, otherwise known as duties.

Because directors are supposed to represent shareholders' interests, directors have a fiduciary duty to conduct activities to enhance the firm's profitability and share value. Related to their fiduciary duty, directors also have a duty of loyalty and fair dealing, where they must put the interests of shareholders before their own individual interests. In addition, directors must also exercise a duty of care by doing what an ordinary prudent person would do under the same position and circumstances. Exercising this duty involves being informed and making rational decisions. Finally, the board of directors has a duty of supervision, in which they should establish rules of ethics and ensure disclosure. In this regard the board should hold regular meetings to review the firm's performance, operations, and management, and it must make sure that accurate financial reporting and objective auditing are taking place.

3.1.2 Board Committees

A great deal of important board work occurs at the subcommittee level and subsequently goes to the full board for approval. Some boards

include an executive committee, a finance committee, a community relations committee, and a corporate governance committee, among others. The most common board subcommittees are the following:

- audit committee
- compensation committee
- nomination committee

The audit committee is charged with finding an independent auditor for the firm's accounting statements and the committee must ensure that the auditor will do its job objectively. The compensation committee is responsible for setting and designing the executive compensation package. The nomination committee searches for and nominates candidates to run for impending vacancies among board seats in annual shareholder elections. A separate stock options subcommittee has gained popularity with boards in recent years, probably due to the controversy surrounding stock options.

3.2 Who is a Director?

A company is a legal person endowed with all the powers of a natural person with powers to carry out all the objects set out in the memorandum of the company. The direct implication of this is that the management of the affairs of the company is entrusted to human agents, called the *directors.*

- Section 650 of the Companies and Allied Matter Act, 1990 defines directors as including any person occupying the position of directors by whatever name called. Directors are managers of the company; they are not “employed” by the company and therefore not as such employees of the company nor are they servants or member of staff of the company. Directors are officers of the company for the purpose of making a company vicariously liable for their negligence while engaged in the business of the company.

Prior to the mid-1980s, the public paid little heed to directors and thought them merely ornamental features of corporations. However, the situation has changed. Increased pressure on the board of directors to provide better corporate governance possibly began as a response to the tidal wave of mergers and acquisitions (M&A) activity of the 1980s. A recession and the collapse of the junk bond market resulted in a temporary M&A decline during the late 1980s, but M&A activity was strong again in the 1990s. In fact, since the mid-1990s, M&A activity has taken off in the U.S. Some of the largest mergers ever have taken place in the last 10 years.

Why would an increase in M&A activity lead to more board scrutiny? When one firm acquires another, it usually has to pay significantly more than the going market price. This situation is advantageous for the target firm's shareholders but not for the acquiring firm's shareholders. The boards of both firms must approve the acquisition before it goes to a shareholder vote. For the acquirer, the shareholders may not wish to pay too much for a target, or may not wish to acquire the target at all. For the target firm, the shareholders may want to make sure that firm is acquired for a nice price, or perhaps not acquired at all. Consequently, the shareholders of both the potential acquirers and targets keep a close eye on their respective boards during a prospective takeover.

The increased takeover market and the new regulatory environment for shareholder communication caused shareholders and the general public to put more pressure on directors to do their jobs. However, because these changes occurred or took shape only recently, the avid attention being paid to boards is a recent phenomenon.

3.2.1 Directors' Powers

The Act and the articles regulate the powers of directors. The company may, however, in general meetings act in certain specified circumstances, e.g.

- act where members of the board are disqualified or are unable to act because of a deadlock on the board otherwise or are unable to act because of a quorum cannot be found.
- institute legal proceeding in the name and on behalf of the company if the boards of directors refuse or neglect to do so.
- ratify or confirm any action taken by the board of the directors, or
- make recommendation regarding action to be taking by the board.

Sometimes the directors are authorised by the article to exercise certain specific power of the company, e.g. the director may be authorised to exercise all the borrowing power of the company subject to any restriction as to amount as may be imposed.

An action in the name of the company must be authorised either by the company itself in a meeting of the shareholders convened for the purpose or by the directors of the company or if it is not so authorised, the action must be dismissed. Before a director can authorise the bringing of an action in the name of the company, he must have been appointed as a director in accordance with the procedure laid by the article of the association of the company.

The power vested in the director must be exercise by them as board and no individual director or group of directors can bind the company unless the power of the board has been delegated to him as provide by the actor the article since the board has no inherent power to delegate any of its power of decision to one or more of its member or to other person.

The directors may delegate some of their power to a committee of directors or a managing director to whom they may entrust any of the power. The director, in a normal course of business, will need to delegate power to staff and officers.

Apart from removal and vacation of office, the power of the directors may be terminated on making a compulsory winding up order or the appointment of a liquidator in a voluntary winding up.

3.2.2 Directors' Duties and Responsibilities

The principles on which the duties of directors are based are now set out under the provision of Section 279 of the Company and Allied Matter Act, 1990.

(a) **Fiduciary duty of directors**: The following are what constitute fiduciary duties of a director, especially within the ambit of good corporate governance.

- The duty of utmost good faith which is contained in section 279 (1) of the Company and Allied Matter Act,1990
- The duty to act in the best interest of the company as a whole, which is contained in section 279 (3) of the Company and Allied Matter Act, 1990.
- The duty to exercise power for proper purpose and not for a collateral purpose as in section 279 (5) of the Company and Allied Matter Act, 1990.
- Duty not to fetter discretion as in section 279 (6) of CAMA, 1990.
- Duty to avoid conflicts of interest as in section 280 of CAMA, 1990.
- Duty to disclose their interest in a contract with the company as provided for under section 277 of CAMA, 1990.

(b) **Duty of care and skill**: This is provided for by section 282. The standard of care and diligence is set is out in section 282(1) of CAMA, 1990 which is to the effect of every director of a company shall exercise the power and discharge the duties of his office honestly, in good faith and the interest of the company, and shall exercise that degree of care, diligence and skill which a

reasonably prudent director would exercise in comparable circumstances. If he fails to observe that degree of care and diligence, he may be liable for negligence and breach of duty.

3.2.3 Enforcement of the Duties of Directors

Generally, it is the responsibility of the company to enforce duties of the directors but because the administrative machinery of the company is in the hands of the directors, it becomes impossible for the company to enforce the duties of the directors. The usual way of enforcing the duties of the directors is through removal but because in several companies, the director will normally be the controlling shareholders, it thus becomes difficult to remove the directors. In such situations, the followings are the remedy available to the shareholder.

- Petition for winding up for the company on the ground that it is just and equitable to do so
- Relief on the ground that the affairs of the company are being conducted in an illegal and oppressive manner (s.311) of CAMA, 1990.
- Misfeasance of proceeding in a winding up (s.311) of the Company and Allied MatterAct, 1990.
- Investigation of company's affair under (s.314 and 315) of CAMA, 1990.

SELF ASSESSMENT EXERCISE

What regulations govern the functions and structure of boards of directors? What is legally required of directors? What are the primary roles of boards, board sub-committees and directors?

4.0 CONCLUSION

A firm's board of directors plays an important role in reducing problems inherent in the separation of ownership and control. Indeed, the board is responsible for hiring, evaluating, and sometimes firing the firm's executives. In addition, the board oversees the firm's auditors and makes major strategic decisions for the firm. They are to conduct these activities in the best interests of the shareholders.

5.0 SUMMARY

Shareholders and regulators have only recently started paying attention to the activities of boards of directors. There are many potential problems with the organisation of many corporate boards. For example, it seems that many directors lack the independence, the vested interest,

the time, and sometimes the expertise to carry out their fiduciary obligations to shareholders. However, the recent attention directed to boards has caused some changes to occur (especially regulatory changes) but it is too early to tell if these changes are taking hold.

6.0 TUTOR-MARKED ASSIGNMENT

1. When can a person be refered to as a Director?
2. Within the context of good governance, outline the fiduciary duties of a director

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MODULE 4

Unit 1 Investment Banks and Securities
Unit 2 Creditors and Credit Procedures
Unit 3 Activities of Shareholders
Unit 4 Corporate Takeovers: Mergers and Acquisition
Unit 5 Corporate Citizenship

UNIT 1 INVESTMENT BANKS AND SECURITIES

CONTENTS

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 3.1 Investment Banking Activities
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 3.3 Security Analysis
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

This unit deals with investment banks and securities analysts. Investment banks offer a variety of services but their most notable business is selling newly-created securities. When a private firm wants to become a public firm, it will obtain the services of an investment bank to design and to sell the new stocks for the investing public to purchase. When an already public firm wants to raise additional capital to finance its on-going activities or future growth, it will also obtain the services of an investment bank to sell its newly-created securities to the public. One can think of investment banks as intermediaries who sell new securities on behalf of firms.

The primary job of analysts is to evaluate securities and then to make buy and/or sell recommendations to their clients based on their evaluations. Analysts are also expected to make earnings forecasts for the firms that they follow in order to help investors make their own buy and/or sell decisions.

Most corporate governance texts might not consider investment banks and securities analysts as part of the corporate governance system. However, because investment banks evaluate their client firms' needs and bring investment opportunities to the market and because analysts frequently possess better information than most investors about a company, both investment banks and analysts are in a good position to monitor the firm and to identify problems for shareholders. We would expect investment bankers to sell "good" securities (i.e. they should not be selling securities of a poorly run firm) and for analysts to recommend "good" securities (i.e. they should not be recommending stocks that they think will go down in value). Therefore, they both do represent an important and integral part of the corporate governance system. This unit first discusses investment banks and then it discusses analysts.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain investment banking activities
- outline the criticisms of investment banking
- define securities analysts.

3.0 MAIN CONTENT

3.1 Investment Banking Activities

The basic investment banking service is to help companies issue new debt and equity securities. A firm can issue several different kinds of securities. The bank advises the company on the optimal security (stocks, bonds, etc.) for the amount of capital being raised, while taking into account the company's situation. The investment banks charge the company a fee for this service. The size of the fee depends on how much risk the investment bank takes to issue the securities. There are two methods that banks can use to issue stock and bonds: underwriting and best efforts.

Think about the case of issuing stock. When underwriting an issue, the bank will guarantee that the company will receive a specific amount of capital. That is, the banker assures the company that a certain number of shares will sell at a target price. If too few shares sell at that price, the investment bank must buy those shares. For example, if a bank guarantees that it will be able to raise N100 million in capital for the issuing firm but is only able to sell N70 million worth of stock, then the bank would have to buy N30 million worth of stock.

If the investment bank did not want to assume the risk on a security issue, it could use the best-efforts method. Here the bank does not guarantee that the firm will get its desired amount of capital. The bank does its best to sell as much of the new security as possible for the company. In this case the company takes the risk of not receiving enough capital. Because the risk is low for the investment bank, the fee charged is much lower for the best-efforts method than for underwriting.

The process of selling securities to public investors first involves registering securities with the SEC. The document submitted to the SEC includes a preliminary prospectus containing information about the security issue and the company. For example, the prospectus details the company's financial condition, business activities, management experience, and how the funds raised will' be used. The bank distributes the final prospectus to investors interested in the securities issue. Note that this information helps investors make decisions about the condition of the company and about buying the issue. In other words, investment bankers are an important source of information and monitoring of a public company.

The prospectus and the banker's "road show" relay information about the company to investors. The road show is the marketing campaign done by bankers to generate interest and to market the issue. They travel the country visiting large institutional investors such as public pension funds and mutual funds. To sell to individual investors, investment banks use their brokerage operations. For a "hot" issue, investors call the brokers to order shares. In a less popular issue, the brokers call investors.

Information about the issuing company is especially important to investors when the firm is new. When a firm offers stock to the public for the first time in an IPO, the company is typically young, small, and mostly unknown to investors. The information gathered by the investment bank and presented to the SEC may be the only independent data available on the firm. Therefore investors expect the bank to disclose all relevant information in order to make good investment decisions.

Investment banks experience greater risk when underwriting an IPO, as opposed to underwriting an SEO, because of the uncertainty involved with new firms. To mitigate some of the risk, banks tend to under price IPO offerings. That is, banks offer the new shares of stock at a lower price than the demand for the stock would suggest.

3.2 Criticisms of Investment Banks

3.2.1 IPO Problems

Investment banks take small private firms public in IPOs. These small firms want to expand using the capital that the stock issue provides. Every small business owner would like to gain tens or hundreds of millions of naira to spend, but few small businesses would make good public companies. That is, the business model of many small firms would not work effectively as large, national firms. In addition, small business owners may not be capable of running a large business.

Typically, only small fractions (less than 1 percent) of firms that want to conduct an IPO actually do. Who decides which firms go public? Investment banks make this decision. After all, they take the risk as the underwriters. The banks thoroughly examine potential IPO firms. Traditionally, the policy of many banks has been to bring a firm public only if it has put together a good management team, developed a quality business plan, and perfected its business model enough so that it has earned profits in the past three quarters.

3.2.2 Structured Deals

When companies need more capital, they turn to investment banks. Raising capital can be difficult. As an extreme example, consider a firm facing bankruptcy. In bankruptcy, the equity of the firm is taken from the stockholders, who gain nothing, and given to some of the creditors. Therefore, investors are not likely to buy additional shares of a financially troubled firm. The firm would also have trouble borrowing money from banks or from bond investors because these creditors typically do not recoup all their money in the bankruptcy court.

Often a firm has trouble raising capital, even if it is not on the brink of bankruptcy. For example, the current creditors of the firm may have stipulated in their loans that the firm cannot borrow more money unless they are repaid first. Also few firms can successfully issue additional stock when investor confidence is low.

3.3 Securities Analysis

Analysts generally fall into two categories: buy-side and sell-side. Institutional investors, such as pension funds and mutual funds, hire analysts. Their purpose is to help decide which' stocks the fund should buy; therefore; they are referred to as buy-side analysts. The recommendations of these analysts are not public and they are only seen and used by the institutional investors. Fund managers are managing

money on behalf of individual investors, such as retirement accounts, so they are an important part of the corporate monitoring system. Alternatively, brokerage and investment banks also employ analysts. These analysts hope that their research will generate enough interest in a security that their firm will generate trading commissions or underwriting business. As such, brokerage and investment bank analysts are commonly known as sell-side analysts and they often appear to act like salespeople for the stocks that they cover. The recommendations of sell-side analysts are commonly made public. Many investors rely on these recommendations and therefore sell-side analysts are also part of the corporate monitoring system. Our focus here will be on sell-side analysts.

To do his job, a sell-side analyst will look at a firm's operating and financial conditions, the firm's immediate and long-term future prospects, the effectiveness of its management teams, and the general outlook of the industry in which the firm belongs. Most analysts follow a specific industry to gain expertise in a particular sector. Based on their evaluations, analysts will make earnings predictions.

Usually they will try to predict the quarterly earnings per share (EPS) numbers. These predictions are useful to investors who rely on these estimates to determine the health of the companies in which they may or may not own stock. For example, many investors use PIE ratios (the market price of a share of stock divided by its annual earnings per share) as an important gauge of a stock's attractiveness as an investment. Some investors like to examine forward-looking PIE ratios. That is, they use a PIE ratio for next year's estimated earnings.

Therefore, these earnings estimates are important and useful to investors. Perhaps, more important, the analyst also makes trading recommendations to investors. For example, an analyst may suggest buying or selling a particular stock. These recommendations usually boil down to one-word or two-word recommendations such as "hold" or "buy." Further, some recommendations are ambiguous, such as "accumulate," "market performs," and "neutral." Is an "accumulate" recommendation as strong as a "buy" recommendation? Does a "neutral" rating mean "don't sell" and/or "don't buy?" Is a "market perform" rating good or bad? However, while we still see these kinds of recommendations today, there has been a trend toward making analysts' ratings less complicated and vague.

Analyst recommendations should be timely. For example, if on a particular day an interested investor finds that the analyst's recommendation for a given stock is a buy, then that recommendation should reflect the analyst's most recent opinion. This means the

recommendation should be updated frequently. If a news item breaks that could potentially affect an analyst's recommendation, then a revised and updated recommendation should be disseminated immediately. For her or his largest customers, the analyst may even make a phone call. However, a recommendation revision may sometimes have to go through an approval process, which may take a couple of days. Lengthy research reports that are mailed out or personally presented to potential investors may be a bit less timely as well. Nonetheless, investors generally rely on analysts for timely advice.

SELF ASSESSMENT EXERCISE

What are the main ways an investment bank offers a security for sale?

4.0 CONCLUSION

Investment banks play a vital role in the corporate system: They help firms acquire the capital they need to expand business operations. In order to underwrite the securities that firms issue, the banks become intimately familiar with the operations of those firms. This situation gives them a unique ability to be corporate governance monitors. Capital is a scarce commodity and investment banks should be the gatekeepers and ensure that deserving companies obtain the needed capital. This way, they would bring only high quality firms and security issues to the public.

5.0 SUMMARY

Analysts evaluate a firm’s performance and future prospects and then make trading recommendations. For the most part, they generally seem good at it. However, two conflicts of interests in the system may compromise their objectivity at times. First, analysts want to gather good information through access to the management team of the firm, which requires a good relationship. This might be difficult to do when the analyst thinks the firm’s prospects are poor. Second, analysts have been rewarded for luring investment banking business to their employer. Consequently they were encouraged to be bullish on the firms they follow to keep both potential and current investment banking clients happy.

6.0 TUTOR-MARKED ASSIGNMENT

1. Why is the problem of IPO a criticism of investment banks? Explain
2. When is a security analyst said to be on the “buy-side”?

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UNIT 2 CREDITORS AND CREDIT PROCEDURES

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 3.2 Institutional Lenders as Corporate Monitors
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1.0 INTRODUCTION

So far, we have discussed corporate governance as if only stockholders should care about it. However, those who lend money to the firm (i.e. creditors) are also important investors to that firm. Therefore, lenders care about corporate governance too. In general, there are two kinds of lenders, institutional lenders such as a commercial bank and individual investors such as a bondholder.

Creditors can trade their claims just as stockholders can. For example, bondholders can sell their bonds to other investors (and banks can sell their loans too but primarily to other institutions). If firms suffer from poor corporate governance, then the value of their bonds might decline just like the value of the stock. If a firm collapses from poor corporate governance then lenders may get back only kobo on the naira of their loan.

While a bank may find it worthwhile to monitor the firm that they lend to (because millions, even billions, could be at stake), individual bondholders may not have the resources to do so. Fortunately, debt, in and of itself, could be a governance mechanism (we will explain this in more detail soon). Further, there are also credit rating agencies that rate the safety level of corporate debt. As such, they can provide important information to potential bond (investors). Therefore the existence of corporate debt creates three important corporate system monitors or devices:

- monitoring by institutional lenders;
- debt, in and of itself, can be a disciplinary mechanism; and
- monitoring and debt ratings by credit agencies.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- identify debt as a disciplinary mechanism
- explain institutional lenders as corporate monitors
- describe the activities of credit rating agencies.

3.0 MAIN CONTENT

3.1 Debt as a Disciplinary Mechanism

When a firm has debt, it usually has to make promised interest payments every year. If the firm misses an interest payment, the lender can sue for control of the firm. On the other hand, if the firm's stockholders are not promised anything and though a firm can pay a dividend to its stockholders at the discretion of its board of directors, it is not legally obligated to do so. Because interest payments represent fixed annual obligations of the firm, debt actually imposes discipline on to the firm's management. That is, the firm's management has to generate enough revenue each year to cover the firm's interest expense. If the managers fail to do this, then they could lose control of the firm to a creditor.

While interest expense represents an important revenue hurdle that managers have to overcome and is thus a potentially effective motivator for management, it also discourages superfluous spending by management. That is, it limits managerial discretion. Of course, having to make large annual interest payments can also restrict a manager's flexibility to make value-enhancing capital expenditures when opportunities "suddenly" arise. Therefore, the use of debt to discipline firms may be limited primarily to mature firms.

Finally, in addition to a promised interest payment, other explicit covenants (these are rules, promises, and/or restrictions that the borrower agrees to legally adhere to) can be written into the debt contracts, such as guarantees by the borrower to protect its collateral value. The breaking of any covenant can transfer control of the firm from management to creditors. Because creditor rights are usually more explicit than shareholder rights, debt potentially provides better protection to investors than equity.

3.2 Institutional Lenders as Corporate Monitors

Banks will of course monitor firms that they lend to. Sometimes a firm will develop a long-term relationship with a bank. Relationship banking might be beneficial to the borrowing firm on at least two counts. First, the firm might be able to get a favourable interest rate from its bank. Second, the firm may feel it will be easier to renegotiate debt contracts (if necessary) with a single lender (i.e. the bank) than with disperse lenders (i.e. bondholders).

However, getting favourable interest rates from banks often entails the firm having to expose private information to the bank. For example, a firm may wish to borrow billions of naira to embark on a new project. The firm could issue public debt (i.e. bonds) but may find that the interest rate (i.e. coupon rate) is too high for one reason or another (e.g. the firm could already have a lot of debt; the firm could have little collateral assets, etc.). This firm could opt to borrow from a bank or insurance company but to get a favourable rate it may have to reveal intimate details of its project to prove that it is worthy of a low interest rate. Further, the firm may have to agree to numerous covenants to get the favourable bank rate. As a single lender, it is easy for a bank to enforce covenants. Therefore the bank may end up having too much power over its borrowers.

Why Didn't Lenders Raise a Red Flag During Corporate Scandals?

A firm’s creditors and stock holders are often both viewed as investors but in reality creditors are literally lending to stockholders, thus putting these two investors on opposite sides of the credit claim. Therefore, these two investors do not necessarily share the same objectives for the firm.

From the balance sheet, note that stockholders are entitled to the firm's net income after creditors get their interest payment. That is, creditor's claims have seniority over equity holder's claims. This by itself can cause divergent incentives between the two claimants. Say, for example, the firm has to choose between a risky project with an uncertain high payoff and a safe project with a more certain marginal payoff. The return on the safe project may barely leave anything left over to stockholders once creditors are paid. Therefore stockholders may favour the risky project over the safe one but creditors might be indifferent between the two projects if both of them can cover the firm's interest expense. Because creditors get their returns first, they may have less incentive to monitor managerial behaviour than stock holders. Of course there is the possibility that managerial risk-taking may be so excessive that interest payments and principle repayment cannot be made but

under these extreme circumstances, creditors can then force the firm to liquidate its assets to recover at least some of their investment claim.

Because debt claims are senior, both to the revenue and to the liquidation value, creditors may be less active in monitoring than stockholders.

3.3 Credit Rating Agencies

Just as analysts help rate stocks for potential stock investors, credit rating agencies rate bonds for potential bond investors. However, because bond investors are primarily risk-averse investors, they primarily care about the risk of the bond, which is the focus of these credit rating agencies.

The safety level of a bond is very important to those who choose fixed income investments. The best return a bondholder can receive is both interest payments during the term of the bond and the principal upon maturity of the bond. Therefore bondholders focus on safety. How do you know if a firm's debt is safe or risky? Corporate bonds are given a safety rating.

3.3.1 The Ratings

To assess the credit worthiness of companies, the credit agencies employ financial analysts who examine the firms' financial positions, business plans, and strategies. This means that the analysts carefully review public financial statements issued by the companies have no obligation to reveal special information but they often do so to convince the agencies that their debt issues should be rated highly. Credit analysts can often question CEOs and other top executives directly when conducting reviews because of the importance of credit ratings.

3.3.2 Criticisms

One criticism of credit agencies is that they have started to enter the consulting business. Being both consultants and credit raters creates a conflict of interest similar to the one that occurred when auditing firms were also consultants for a company. If the credit agency is earning lucrative consulting fees, then it might not be able to provide unbiased analysis of the firm's financial position. Just as auditing firms should not be allowed to audit companies where they act as consultants; neither should credit agencies rate the debt securities of companies to which they provide consulting services.

When designated agencies make mistakes, they often claim the company executives lied to them. However, the agency's job is to validate the information they receive and then make conclusions based on its own analysis. What purpose do agencies serve as independent monitors if they simply follow the lead of the company executives?

SELF ASSESSMENT EXERCISE

1. Find two firms from the same industry, but with different debt ratios. Try to work out why the two firms have different debt ratios. Try to find another pair of firms that have different debt ratios, but for another reason.
2. Identify a firm that has more bank debt than public debt and vice versa. Try to work out why each firm prefers its debt type.

4.0 CONCLUSION

When a company obtains capital through borrowing money, it also obtains another governance mechanism. The need to pay interest and principle payments disciplines executives to manage the cash flow of the firm carefully and it also discourages superfluous spending. Those institutions and investors who lend the firm money become another monitor of the firm. Large creditors, such as banks, insurance companies, mutual funds, and pension funds, often develop close relationships with firms and can be effective monitors. Individual investors tend to rely on the recommendations of credit rating agencies.

5.0 SUMMARY

The credit agency’s purpose is monitoring debt issuers to protect public investors. However, the industry's structure creates a situation in which the agencies interact only a little with the investors they are protecting. Instead debt issuers pay agencies to give a rating. Agencies work with the issuers and the investment bankers to obtain information about the debt issue. Most of their business relies on the interactions with corporate participants, not with investors. In this process, they gain access to private information about the firm.

Most of the agencies’ interactions and the fees they earn are with the firms they rate, not the investors who use the ratings. This circumstance can create misaligned incentives

6.0 TUTOR-MARKED ASSIGNMENT

1. In what ways does debts acts as disciplinary mechanisms?
2. What are the criticisms of the credit agencies?

7.0 REFERENCES/FURTHER READING

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UNIT 3 ACTIVITIES OF SHAREHOLDERS

CONTENTS

1.0 Introduction
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3.0 Main Content
3.1 What is Shareholders Activism?
3.1.1 Activities of Individual Shareholders
3.2 Obstacles to Effective Shareholder Activities
3.3 Powers and Rights of Shareholders
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1.0 INTRODUCTION

When corporate scandals occur, shareholders are often viewed as innocent and helpless victims. Investors may be categorised into two groups: individual investors, such as you, your parents, and Microsoft's Bill Gates, and institutional investors, such as pension funds, insurance companies, and mutual funds. Many institutional investors actually invest on behalf of many smaller individual investors. Shareholders, both individuals and institutions, lose money when corporate scandals occur and firms subsequently go bankrupt. Thus they have expressed a desire for more protection and monitoring of their firm. The very desire for more protection has everyone, from the stock exchanges to the government trying to find ways to protect investors. However, one question that begs asking is why cannot shareholders also take care of themselves? That is, why do they not take more responsibility for the stocks that they own?

People who own homes will often take precautions to safeguard themselves against burglary. Various ways to protect a home range from forming a neighbourhood watch, buying a watchdog, or installing a security system to simply locking the doors each night. Of course, homeowners also rely on the local police to protect their homes, much like investors might rely on the government to protect their investments, but the police obviously cannot guarantee that all homes will be perfectly protected. This is just as true with shareholders' stocks.

There are valid reasons why individual investors do not pay more attention to what they own. Most individual shareholders do not own enough stock in anyone company to be able to influence its management. Nor do most shareholders think it worth their time and

effort to do anything. The gains (e.g. stock price increases) from their efforts would be shared by all other shareholders, while they alone would bear the costs.

If shareholders do anything at all, they sell shares that they are unhappy with Institutional shareholders that own many different stocks have some restrictions about what they can own and, for them, exerting some of their ownership rights may be worthwhile. Further, given the large amounts of stocks that these shareholders own, they may be able to affect the decision-making of the firm. Also the potential benefits accrued from their activism may be large enough to be worth the effort. Perhaps institutional shareholders can do more, especially given the fact that individuals have entrusted them to invest their money.

Therefore institutional shareholder activism could play an important role in monitoring management.

This unit discusses investor activism of various forms, including ways that individual shareholders can exert some influence over the firms that they own. The focus, however, will be on activism by institutional shareholders. Problems and constraints that institutional shareholders currently face are also described.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain shareholders activism
- describe institutional shareholder activism
- identify the obstacles to effective shareholder activities.

3.0 MAIN CONTENT

3.1 What is Shareholder's Activism?

There is no formal definition of shareholder activism. Loosely speaking, any time shareholders express their opinions to try to affect or to influence a firm they are being active shareholders. A renowned example in this nation is by name, Asiwaju Akintunde Asalu who parted this world on 27th December, 2007. During his lifetime, he was referred to as the doyen of shareholders in the Nigeria business environment.

Shareholders who vote their shares submit proposals to be voted on or attend annual shareholder meetings could certainly be considered active. Even writing a letter to management regarding some aspect of the firm's operations or social policies could be considered investor activism. We

discuss the activism by three kinds of shareholders: individual shareholders, large shareholders (defined as the owner of a large portion of a firm's shares), and institutional shareholders. Note that these shareholder types are not mutually exclusive. Either an individual or institutional investor can be a large shareholder.

3.1.1 Activities of Individual Shareholders

An individual investor with only a modest number of shares is able to attend shareholder meetings, submit proposals to be voted by at those meetings and vote at those meetings. Lewis Gilbert is generally credited with being the first individual shareholder activist. In 1932, as the owner of 10 shares of New York's Consolidated Gas Company, he attended its annual meeting. While at the meeting, he was surprised and appalled that he was not given a chance to ask questions. After all, he was a part-owner (albeit a small one) of the firm. Subsequently, Gilbert and his brother pushed for reform and, in 1942, the SEC created a rule to allow shareholders to submit proposals that could be put to a vote.

Today, most shareholder proposals are governance-oriented, primarily attempting to forge an alignment between shareholder views and managerial actions. For example, proposals may address issues related to anti-takeover amendments, shareholder voting rules, or board composition. Having these proposals passed or even brought to the attention of the managers, can certainly have a potentially positive effect on the firm.

In practice, however, most shareholder proposals submitted by individual investors do not pass especially those that go against management desires and those that involve obtaining a board seat. One reason is that it is difficult and expensive for one shareholder to communicate with all other shareholders, while it is easy for management to express its opinions and recommendations on submitted proposals.

In the academic literature, large shareholders (both manager-owners and just plain owners) are in fact found to be active monitors of the firm. This should not be surprising as they have the incentive and the power to be effective monitors. Think of it this way: if two firms are identical in every way but one firm has one or two large shareholders who own 10 per cent of the firm each, while the other firm has dispersed shareholders where no single shareholder owns more than 0.1 per cent of the firm, then which firm might be better monitored by its shareholders? Probably, the firm with the large shareholders.

It is also worth pointing out that the latter hypothetical firm probably resembles many real public firms for at least two reasons. Some public firms can be so large that it would take a lot of wealth to own a significant fraction of it. Further, most investors may not wish to forgo the benefits of portfolio diversification by investing so heavily in anyone particular firm. So while large shareholders are useful monitors, there may not be a lot of investors who have the capital or the desire to be a large shareholder.

There is also a possible third reason why many firms do not have large shareholders. While large shareholders are found to be effective monitors, there is not a consensus on whether or not the presence of a large shareholder leads to higher firm values. This might be somewhat surprising but it is possible that there are firms that have a particular need for large shareholders and some that do not. For example, a growth-oriented firm that is in an initial stage of its life-cycle may need monitoring by a large shareholder, while a mature firm may require less shareholder monitoring. Further, it is simply difficult to isolate the relation between shareholder activism and firm performance because so many other factors are involved. So while the importance of large shareholders on corporate governance might be unquestioned, its importance on firm value is an on-going debate among business scholars.

Large shareholders can, of course, be institutional investors. In fact, because institutional investors have access to enormous sums of money, we generally think of them as being the large stockholders of public corporations rather than individuals. However, institutional investors may be limited in their ability to monitor the firm. This might be why the relationship between large shareholders and firm value is tenuous. We discuss these issues next.

3.2 Obstacles to Effective Shareholder Activities

As stated by Bernard S. Black, a Columbia law professor and well-known advocate of shareholder activism, “Pension funds are encouraged by law to take diversification to ridiculous extremes.”

Why do these restrictions exist? In general, the public fears having single entities with so much power. This means that funds are limited in their ability to become a major shareholder of anyone firm and thus they are constrained in their ability to become stronger and more influential owners.

Bernard S. Black and another law professor, Mark J. Roe, have adamantly argued that legal restrictions stand in the way of large

investors engaging in the beneficial oversight of corporations. The pair contends that the legal and regulatory environment prohibits or discourages institutional investors from becoming too large, from acting together, and from becoming significant owners. At the same time these investors face tremendous NSE paperwork if they do wish to accumulate a significant stake in a firm, while also facing unfavorable tax ramifications in the process. Meanwhile, only a few laws actually encourage or make it easier for institutions to be effective owners.

3.3 Powers and Rights of Shareholders

Shareholders are the owners of the company and consist of individual and corporate members. As shareholders they have powers and rights which no group or even the company can lawfully deprive them. They relate to the privileges that are appertaining to the status of a particular shareholder.

The rights as entrenched in the statute, memorandum and articles of association include.

a) Personal or individual rights, which include:

1) The right to vote
2) The right to refuse to consent to an increase in shareholding
3) The right to exercise various statutory rights.

Where these individual or personal rights are breached, the shareholder has the power to suit in his personal capacity. This is because the injury is done to him in his personal capacity and in such case he does not require the consent or approval of any other shareholder to institute an action to protect his right.

SELF ASSESSMENT EXERCISE

Outline the powers and rights of shareholders.

4.0 CONCLUSION

Shareholders rely on other monitors, such as the NSE, to protect their investments but they should also be more vigilant themselves. After all, it is their money and life savings. When shareholders are active monitors of the firms in which they own stocks, their activism is commonly referred to as “shareholder activism.” However, it is difficult and rare for individual investors, like you, to be active and effectual. Institutional investors, on the other hand, are large shareholders, so they may be able to monitor effectively. In fact, institutional investors, such as pension

funds, actually invest on behalf of their plan participants. Therefore, it could be argued that these investors should be active shareholders.

5.0 SUMMARY

There are some institutional investors that do earnestly try to engage in shareholder activism. However, for the most part, most institutions are not active shareholders. This situation may exist because institutional investors face incentive problems, conflict of interest dilemmas, and regulatory constraints. Should we give institutional shareholders more power? Or is there a downside to them having too much ownership and power.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the problems hindering the effective activities of shareholders?
2. When are shareholders said to be effective?

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UNIT 4 CORPORATE ,TAKEOVERS: MERGERS AND ACQUISITIONS

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1.0 INTRODUCTION

Mergers and Acquisitions (M&A) are significant and dramatic events. Yet they are relatively commonplace in the corporate world. In recent years, the world has experienced some of the largest M&As ever. For example, UBA and Standard Trust Bank, Platinum Bank and Habib Bank becoming bank PHB, and various banks merged in Nigeria recently in the recently concluded consolidation exercise.

America Online acquired Time Warner in 2001, Pfizer bought Warner-Lambert in the 2000, Exxon and Mobil merged in 1999, and SBC Communications merged with Ameritech, also in 1999. These mergers among others created some of the largest firms within their industries. During the 1990s and 2000s, the UK seems to be riding its own merger wave. Some of these recent large mergers have been cross-border mergers, such as Vodafone's (O.K.) acquisition of Air Touch (US.). Less than one year later, Vodafone Air Touch acquired Mannesmann (Germany).

There are many characteristics associated with M&As. Mergers can be characterised by:

- the type
- the valuation of the firms involved;
- the payment
- the new corporate structure; and
- the legal issues

The merger type could be between firms in the same industry or different industries, or they could even be vertical mergers where a firm might acquire one of its suppliers. Participants negotiate over what is a

"fair" price when a firm is trying to acquire another firm. Payment can be made with their cash holdings, borrowed money (often known as leveraged buyouts (LBOs), and most often with newly created stocks. What will the new corporate structure look like? Who will be in charge and, which managers or business lines will be retained? Government agencies try to determine if a merger significantly reduces competition, in which case it may be deemed illegal, and therefore challenged, by the federal government. There is also the general issue of costs and benefits of conducting M&As, to both the firms and to society. Many business schools have separate courses that treat M&As as a stand-alone topic.

At this point a question that business students might ask is, "Why is a book on corporate governance discussing M&As?" During the 1980s, there were occasions where "bad" firms were acquired by other corporations and even (famously) by individual investors, who then subsequently imposed dramatic changes (such as firing the target firm's top managers) to improve the acquired firm's profitability. These kinds of corporate acquisitions were often resisted by the target firm's management because they were afraid of losing their jobs after their firms were acquired. These kinds of takeovers are often referred to as "hostile takeovers." Such hostile takeovers are sometimes known as " disciplinary takeovers" because they represent one process in which "bad"" managers and/or "bad" operating procedures can be eliminated once their firms are taken over.

This unit first provides a brief overview of M&As. However, the unit is not about M&As per se so students are highly encouraged to read other corporate finance books if they wish to learn more about this exciting topic. After the brief introduction, we will then discuss hostile takeovers in more detail and also characterise the nature of the disciplinary takeover. Perhaps most importantly, we will discuss how firms and their managers are able to defend against unwanted takeovers. We believe that these takeover defenses (both at the firm level and at country level) may have severely hindered the disciplinary takeover market during the last two years. We then offer some international perspective on takeovers.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define merger and acquisition (M & A)
- describe takeover defences of target firms
- explain the assessment of takeover defences
- explain the international perspective of takeovers as a governance mechanism.

3.0 MAIN CONTENT

3.1 A Brief Overview of Mergers and Acquisition (M & A)

Mergers and acquisitions can occur for a variety of reasons. Firms can merge for strategic reasons to improve operational or financial synergies. In 1999, the merger between Exxon and Mobil led to reduced oil exploration costs. Firms can merge to diversify by expanding into new businesses. The AOL and Time Warner merger brought together new and old media. (Le. AOL's internet service and Time Warner's cable (CNN, HBO) and print media (Time, People, Sports Illustrated).

Mergers can be both synergistic and diversifying. The Morgan Stanley and Dean Witter merger brings together an investment bank that underwrites securities and a retail brokerage firm that sells securities. A diversifying merger can also be extreme in the sense that two very different businesses are joined together. General Electric's acquisition of the television company, NBC, during the 1980s, is a classic example of an extreme diversifying merger. Corporate diversification can make the combined firm's profits more stable but there is some debate about whether or not diversifying mergers are good for shareholders.

Most of the recent mergers have occurred for growth and for increased market power. Mergers between UBA and Standard Trust can be viewed as market-power enhancing mergers. In recent years, these kinds of mergers seem to be popular with banks, pharmaceuticals, oil companies, and telecommunication firms. In a broad sense, we could classify all of these merger types into one category: they are synergistic in nature through the cutting of costs and risks and through economies of scale.

While we generally view mergers and acquisitions as being somewhat different (a merger is often viewed as a combination of two or more firms, whereas an acquisition is viewed as one firm buying another), almost all mergers are essentially acquisitions, as there is often an explicit buyer and seller when two firms are joined together. Exxon Mobil is often thought of as a merger between equals but in reality Exxon acquired Mobil; or put another way, Exxon "took over" Mobil.

There is a popular view that smaller firms are more nimble and more *focused* than larger firms in their ability to generate profits. In addition, some believe that managers want to take over companies simply to increase their "empire." This kind of acquisition is often referred to as "empire building." If both of these beliefs are true (and they are both widely popular beliefs), then takeovers may not be good for the acquiring firms' shareholders.

3.2 The Target Firm

Most of the time the “target” firm (i.e. the firm being acquired or taken over) will enjoy a share price increase when its acquisition is announced to the public. Why might this be? A firm, or even an individual investor, may be interested in taking over a target firm because they believe that that firm is not performing up to its full potential or that it could become an even better performer under someone else's control. The acquirer's goal under these circumstances would be to take over the firm and then to turn it around (i.e. to make it profitable) by cutting its fixed or variable costs (either by getting rid of unnecessary expenses or through financial synergy with the acquiring firm), improving its operational efficiency, or by getting rid of its "bad" managers.

Sometimes students new to finance might think it is odd that a successful firm would want to acquire an unsuccessful firm but the rationale is pretty simple. If a firm or an individual were to acquire a successful firm then they would have to pay a large sum for it and the subsequent net gains after the takeover may be limited. However, if a firm or an individual were to acquire an unsuccessful firm then they would only have to pay a relatively small sum for it. The subsequent net gains may be significant if they are able to convert the unsuccessful firm into a successful one. Unfortunately for the acquirer, because the stock market anticipates these subsequent improvements in target firms once they are taken over, the target firms' share price will immediately increase when its acquisition is announced. Acquirers almost always end up paying a significant premium for target firms. An interesting debate among academics and among financial experts in general, is whether or not the premium paid for target firms is ever fully recovered. That is, does the acquisition end up being a positive NPV project for the acquirer?

Because the acquirer often pays a premium for the target firm, the target firm’s shareholders might like it when their firms are taken over. However, the target firms’ management team may oppose being acquired. Once firms are acquired, many of the target firm’s managers are then subsequently fired so that the acquirer can install their own management team into the newly acquired firm. As you can easily imagine, corporate CEOs and MDs generally do not like being fired.

When management balks at a takeover bid from an interested acquirer, the acquirer may then try to take their takeover bid directly to the target firm's large shareholders. If they can buy enough shares then they can effectively take control of the target firm and thus the target firm's management. When an interested acquirer circumvents the target firm's management, it is known as a hostile takeover. However, it can be argued that whether or not a takeover is "hostile" is in the eye of the

beholder. For example, many initial hostile acquisitions are eventually approved by the target firm. Also some firms, fearing a hostile takeover, may try to work out a "friendly" deal with a potential acquirer. In both of these cases, the firms involved may publicly state that their merger was a friendly one.

3.2.1 The Notion of the Disciplinary Takeover

Most of the time, when a firm takes over another firm, we generally do not think of them as a "disciplinary takeover." Profitable firms can also be taken over. Even hostile takeovers are not always viewed as disciplinary takeovers.

However, because some (if not most) firms that get taken over are poorly performing firms, there are many people (such as academics) who view takeovers as an important governance mechanism. If a manager is not doing a good job, either because he is bad at managing or because he is abusing his managerial discretion (i.e. he is using his power for self-serving ends), then his firm might get taken over and he is subsequently fired. In this sense, the fear of a potential takeover might represent a powerful disciplinary mechanism to make sure that managers perform to the best of their abilities and to make sure that managerial discretion is controlled. In a study of over 250 takeovers during 1958-1984, it was found that over half of the target firm's top manager (usually the CEO but sometimes the MD) was fired within two years of the takeover. These statistics are probably representative of today's takeover landscape.

Therefore, in addition to the synergy motive for mergers mentioned previously, we could classify a second broad merger category as the disciplinary takeover. It is important to note that mergers can be for both reasons.

However, while takeovers may be viewed as a governance mechanism, it is not clear that they are an effective one. That is, we might NOT be able to rely on them as being an efficient contributor to the corporate governance system. First, as mentioned above, an acquirer may have to pay too much for a target. Second, takeovers could occur for the wrong reasons (e.g. empire building, corporate diversification). Third, even if the acquirer is able to pay a "fair" price for a target, the amount usually is still significant.

While the idea of disciplinary takeovers as a governance device might be new to some, it may be a more fami1iar idea to those of us who remember the "corporate raiders" of the 1980s. In the U.S. corporate raiders, such as Carl lcahn and T. Boone Pickens were well known to identify firms that could not control their spending. For example, Carl

lcahn took over TWA in 1985 and then dramatically cut TWA's costs. Corporate raiders are obviously *not* seeking a synergistic-type takeover; their takeovers are clearly of the disciplinary type. These disciplinary takeovers benefited target firms' shareholders. They got rid of "bad" managers and in the process they themselves also enjoyed a profit. However, we would be remiss if we did not mention an alternative viewpoint. These corporate raiders were also seen as villains. Because raiders often cut jobs to control costs, many people viewed raiders as heartless cost-cutters who only cared about making profits.

Once raiders obtain enough shares of a firm, they can impose their will on to them. If a disciplinary takeover is profitable in and of itself (even in the absence of a synergy motive) and if it is an effective governance mechanism, then the question that begs asking, is why did we not see more of them? Even when bad firms were taken over in recent years, a synergy-oriented reason rather than a pure investment-oriented reason was usually cited.

There are several possible .reasons. First, share prices might have been inflated due to poor governance, thus making disciplinary takeovers an unprofitable venture. Second, disciplinary takeovers get rid of managers whose questionable actions lead to low, not high, stock prices. For example, if a wealthy individual investor suspects that a manager is “cooking the books,” then this individual may be reluctant to take over the firm whose stock price may be artificially inflated as a result of the manager's questionable acts.

Third and mentioned previously, it costs a lot of money to buy a firm. A fourth reason, and perhaps the most important, is that today there are too many defenses against takeovers. That is, firms can install takeover defenses which may have effectively disabled this governance device from playing an active role in our corporate governance system. These takeover defenses are discussed next.

SELF ASSESSMENT EXERCISE

Outline the characteristics associated with Mergers and Acquisition.

4.0 CONCLUSION

In the U.S, mergers and acquisitions have been on the rise since the 1980s.In the beginning many of these acquisitions could have been termed hostile takeovers, as acquiring firms were looking to take over target firms whose management did not want their firm to be bought. Many of these acquirers believed they could take over poorly performing firms and then convert them into profitable firms. In this way, M&A can be viewed as “disciplinary takeovers.”

5.0 SUMMARY

The recent mergers we have seen seem to be more focused on simply increasing market power. What happened to the disciplinary takeover? In response to the hostile takeover activity of the 1980s, many firms and states adopted anti-takeover devices, thereby weakening a potentially powerful corporate governance device. Besides the U.S, takeover activity is only common in the U.K. However, given worldwide collapses in corporate governance around the world, there is a good chance that we may see a new increased worldwide M&A activity in the near future.

6.0 TUTOR-MARKED ASSIGNMENT

Explain why the takeover of firms is usually termed as disciplinary.

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UNIT 5 CORPORATE CITIZENSHIP

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1.0 INTRODUCTION

The previous units discussed corporate governance from the perspective of agency theory. As described in the first unit, agency theory focuses on the separation of ownership and control. Shareholders (owners) are the central point of concern. From this perspective, corporate governance is mainly about the incentive systems and monitors designed to protect shareholder interests. The primary goal of the firm is to create wealth for these shareholders

However, this is not the only perspective from which to consider corporate governance. Many believe that companies should have a greater responsibility to society. Proponents argue that companies have unique opportunities to improve society. This stakeholder view of the firm describes the firm as having many different groups with legitimate interests in the firm's activities. Corporate governance is then defined as the mechanisms that ensure corporations take responsibility for directing their activities in a manner fair to all stakeholders. Strategic

management concepts argue that this is based on creating positive relationships with stakeholders. Through creating these positive relationships, firms can create sustainable economic wealth.

In particular, agency theory has been an important perspective for formulating governance rules, laws, and policy in, the U.S. However, many other countries have operated under the idea that large corporations have a greater responsibility in society than just maximising shareholder wealth. Their governance rules tend to be influenced to a greater extent by this duty to an expanded set of stakeholders

However, do firms have a sense of social responsibility? Some might say that they do not but others may argue that they should. We discuss the stakeholder view of the firm and we also describe problems with the view, which make it difficult to use this view to ensure good governance.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- describe stakeholders view of the firm
- define governance and stakeholder theory
- explain the criticisms of governance and stakeholder theory
- state the international perspectives of corporate citizenship.

3.0 MAIN CONTENT

3.1 Stakeholder View of the Firm

A company must maintain relationships with several groups that affect or are affected by its decisions. Stakeholders are identified as people or groups with legitimate interests in various aspects of the company's activities. Note that stakeholders are defined by their interest in the corporation, not whether the corporation has any interest in them. Companies have varying responsibilities to each of their stakeholders. While some relationships may be more valuable (or important) than others, no one group should be able to dominate all of the others. These relationships between managers and stakeholders are based on a moral or ethical foundation.

Clearly groups, such as stockholders, employees, and creditors have a strong interest in the firm. But what other groups might be considered stakeholders? Figure 1 shows the different types of groups that might be considered stakeholders of the firm. The primary stakeholders

(sometimes called contractual stakeholders) have direct, contractually determined relationships. While the stockholder is considered a very important stakeholder, other groups are also important. Company employees have short-term interests in the firm in the form of pay and working conditions and long-term interests in the form of pension and health care.

Employees often have labour unions to manage their relationship with the firm. Creditors, customers, and suppliers also have legitimate interests in the organisation. The secondary (or diffuse) stakeholders are impacted by the firm's actions but have limited contractual connection to it. Examples of secondary stakeholders may be its competitors and environmental activists. Certainly, local communities, governments, and all of society may be affected by the company's decisions.

The figure shows just one way to categorise the different stakeholders of a firm. Other distinctions could be made. For example, groupings can be based on the various activities of the firm and those that they impact. It can be based on a resource-view, or industry structure, or by social and political affiliations. Or these stakeholders can be grouped by institutional, economic, and ethical interests. There is no consensus on how these stakeholders should be categorised. However, all the stakeholder views illustrate a much different perspective than agency theory companies have responsibilities to groups other than to stockholders.

A stakeholder view of the firm places its executives at the center of managing relations with each stakeholder group. The managerial objective in this view is to maximise sustainable organisational wealth (all stakeholders' utilities) by optimising these relationships. Many companies now have an organisational unit tasked with communicating with stakeholders. These units may have camouflaged names like "corporate communication department" "or "public affairs department." Others use more direct names like "sustainability group" or "corporate social responsibility committee.

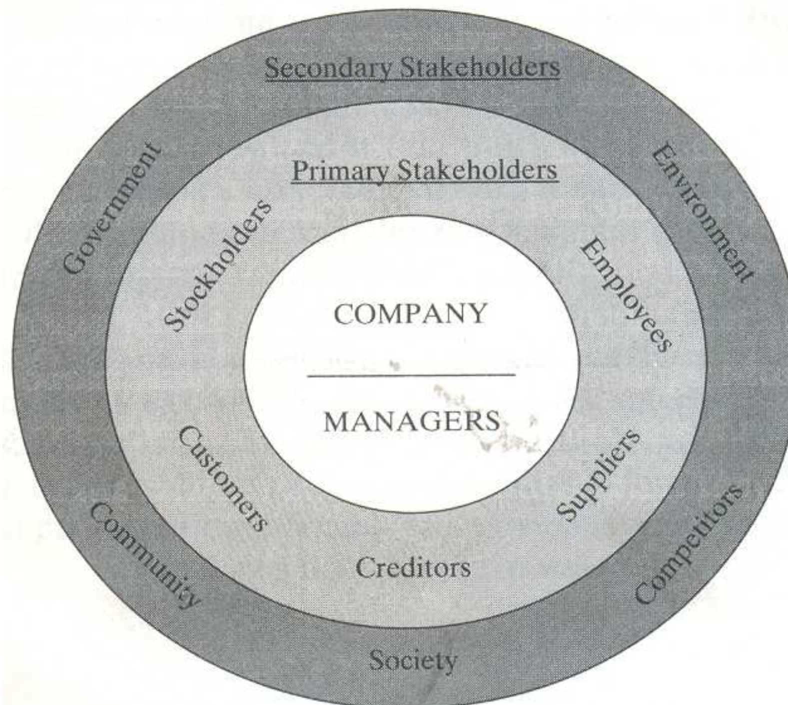

Fig.1: Company stakeholders

3.1.1 Legal Foundations

The legal underpinnings of the stakeholder view of the firm stems from property rights. This may seem ironic because it is the stockholders who own the firm. If stockholders are the owners, do not they have the property rights? Not necessarily. The definition of property can be expressed as a "bundle" of rights, which may be limited. Owners of property have the right to engage in a limited set of activities.

Consider a land-owner; building a home requires a building permit. The government agency that grants the permit must first approve the building plans. The building must meet adequate safety and appearance criteria. Land is also zoned for specific uses. These laws and procedures protect citizens that may go on the property (safety) and the landowners in the area (appearance and use). Although they are not owners of the land, these citizens and nearby property owners are stakeholders of this land. They also have rights.

3.1.2 Corporate Social Responsibility

Corporate responsibility refers to fulfilling the responsibility or the obligation that a company has toward its stakeholders. When we examine a particular corporate practice, like profit versus environmental protection, corporate responsibility can help distinguish between a stakeholder expectation and a corporate obligation, i.e., is the company

obligated to provide absolute environmental protection at all costs or is it obligated to maximise profits for its investors at the cost of damaging the environment?

Corporate social Responsibilities (CSR) can be understood in the term of corporate responsibility, but with grater stress upon the obligation a company has to the community, particularly with respect to charitable activities and environmental stewardship. Corporate and social responsibilities are sometimes described as being a tacit contract between business and a community, whereby the community permit the business to operate within its jurisdiction to obtain job for residents and revenue through taxation.

Lord Holmes and Richard Watts define CSR as the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.

From the foregoing, we can see that CSR is all about how companies manage the business processes to generate profits to itself and produce an overall positive impact on the society from where it obtains all the resources – human, financial, material and other – that aid the mentioned processes. CSR is concerned with the public interest or societal wellbeing.

The modern evolution of the stakeholder view of the firm advocates that management develop specific relationships with stakeholder groups. Proponents of this view argue that companies have a social obligation to operate in ethically, socially, and environmentally responsible ways. This active approach is referred to as corporate social responsibility (CSR) or corporate citizenship.

What is a company's responsibility to society? Archie Carroll has offered a four-part taxonomy of CSR that lends itself to corporate citizenship from a managerial perspective. A firm should conduct its business in a manner that meets its economic, legal, ethical, and philanthropy expectations.

Level I: **Economic**- the first and foremost social responsibility of a firm is economic. The firm must survive by producing goods and services at a profit.

Level II: **Legal**-society expects firms to operate their business within the legal framework.

Level III: **Ethical**-these responsibilities are those over and above the ones codified in laws and are in line with societal norms and customs. They are expected, though not required, by society even though they may be ill defined. This could include things such as environmental ethic.

Level IV: **Philanthropy**-corporate giving is discretionary, although increasingly desired by stakeholder communities.

The economic responsibilities (Level I) have the highest priority. A firm must be efficient and survive over the long term, in order to be useful to society.

However, it must execute its business activities in a legal (level II) and ethical (Level III) way. Philanthropy (Level IV) is the least important priority.

While corporate citizenship might include charity or philanthropy (Level IV), the concept focuses more on engagement with stakeholders to achieve mutual goals (Level II and Level III). Proponents of CSR argue that the main drivers of the citizenship trend include the following:

- globalisation, the worldwide expansion of business and market economies
- greater power of global firms should fill the activities formerly left to Governments
- pressure from assertive social activists
- an increasingly popular environmental movement; and
- a rising desire in the capital markets to punish firms not meeting ethical standards.

Some corporations have responded to this trend by including CSR-oriented statements in their corporate values and goals. These statements recognise that CSR has value in a code of conduct or ethics, a commitment to local communities, an interest in employee health and education, an environmental consciousness, and recognition of social issues (e.g. diversity, social fairness, etc.).

By embracing citizenship goals, advocates claim corporations will insulate themselves from many activist actions, establish stakeholder confidence in management, enhance the firm's reputation, and demonstrate an emphasis on prevention rather than corrective actions. As a result of these perceptions, firms may find that their goodwill opens doors to new communities and additional sales.

However, social responsibility is a dynamic process. It stems from the making of decisions balancing the interests of all stakeholders. But these decisions can only be made from an ongoing conversation among affected parties. For this to occur over time, social awareness must become an integral part of the corporate culture. Ethical considerations become central to this process.

3.1.2.1 Major Social Responsibilities to Shareholders

Ethics affect individual behaviour in the work place. Social responsibility is a related concept but it refers to the overall way in which a business attempts to balance its commitment to relevant group and individuals in its social environment. These groups and individuals are often called organisational stakeholders—those groups, individuals, and organisations that are directly affected by the practice of an organisation and therefore, have a stake in its performance.

Most companies that strive to be responsible to their stakeholders concentrate first and foremost on five main groups: customer: Investors, supplier, and local communities where they do business. They may select other stakeholders that are particularly relevant or important to the organisation and try to address their needs and expectation as well.

Customers: Business that are responsible to their stakeholder strives to treat them fairly and honesty. They also seek to charge fair prices, honour warranties, meet delivery commitment, and stand behind the quality of the products or services they sell. The recent consolidation in banking industry has forced many banks to turn to superior customer services as a major competitive advantage.

Employees: Businesses that are socially responsible in their dealing with employees treat workers fairly make them part of the team, and respect their dignity and basic human needs. In addition, many of the same firms also go to great lengths to find, hire, train, and promote qualified minorities. A socially responsible organisation should strive to become one of the "best organisations to work for in Nigeria." This in turn will attract more individuals who were anxious to work for such highly regarded employers.

Investors: To maintain a socially responsible stance toward investors, marketers should follow proper accounting procedures; provide appropriate information to shareholders about financial performance, and mange the organisation to protect shareholder rights and investments. These marketers should be accurate and the appearance of impropriety in such sensitive area as insider trading, stock price manipulation, and the withholding of financial data.

Supplier: Relations With supplier should also be managed with care. For example, it might be easy for a large corporation to take advantage of supplier by imposing unrealistic delivery schedule and reducing profit margin by constantly pushing for lower and lower prices. Many firms now recognise the importance of mutually beneficial partnership management with supplier. Thus, they keep them informed about that future plans, negotiate delivery schedules and prices that are acceptable to both firm, and so forth.

Local Communities: Most businesses try to be socially responsible to their local communities. They may contribute to local programmes such as MTN's sponsorship of Osun and Ikeji Festival, get actively involved in charitable programmes such as the donations made by several companies to charity homes and churches, and strive to simply be good corporate citizen by minimising their negative impact on communities.

3.1.2.2 Arguments for and against Corporate Social Responsibility

The following arguments have been advanced in favour of social involvement of business.

- Business receives its charter from the society and must respond to their needs.
- Social involvement discourages additional government regulations and intervention.
- The organisation sells products/services to the society. The society buys them thus enabling business to make profits and perpetuate its existence.
- Better social environment benefits both the society and business. The society gains through employment opportunities and goods and services, while business gains in terms of getting its workforces from the society who is also the consumer of its products and services.
- Businesses have great power which should be matched with equal amount of responsibility.
- Internal activities of the enterprises have impact on the external environment.
- Social responsibility may be in the interest of stockholders.
- Social responsibility creates a favourable public image.
- The longer a business stays in an environment, the higher the need for it to contribute towards the development of such an environment.
- Social problems, if allowed to persist, will adequately affect the general public, industries and organisations operating in the

environment. Therefore, organisations contribute to the solution of social problems both in their interest and the interest of the total society

Argument against Corporate Social Responsibility

These include:

- The primary motive of business is profit maximisation. Hence, social involvement can reduce efficiency in maximising organisational profit.
- Since business is not accountable to the society, it should not be involved in social responsibility.
- Business managers lack the social skill to deal with the problem of the society.
- Business has enough power, additional social involvement would further increase its power and influence beyond limits
- Since there is no complete support for social involvement. This could lead to disagreement among groups with different viewpoints.

3.1.2.3 Managing Social Responsibility Programmes

Making a company socially responsible in the full sense of the socials response approach takes a carefully organised and managed program. In particularly, manager must take steps to foster a companywide sense of social responsibility.

1. Social responsibility must start at the top and be considered as a factor in strategic planning. Without the support of top management, no programme can succeed. Thus, top management must embrace a strong stand on social responsibility and develop a policy statement outlining that commitment.

2. A committee of top managers must develop a plan detailing the level of management support. Some companies set aside a percentage of their profit for social programmes. MTN Nigeria, for example, earmarks 1 per cent of pretax earnings for worthy projects. Managers must also set specified priorities. For instance, should the firm train the hard-core unemployed or support the arts?

3. One executive must be in charge of the firm agenda. Whether the role is created as a separate job or tied to an existing one, the selected individual must monitor the programme and ensure that

its implementation is consistent with the firm's policy statement and strategy plan.

4. The organisation must conduct occasional social audit i.e., a systematic analysis of its success in using funds earmarked for its social responsibility goals. Consider the case of a company whose strategic plans calls for spending N10,000,000 to train 200 hardcore unemployed people and to place 180 of them in jobs. If, at the end of the year, the firm spent N9,800,000, trained 210 people, and filled 97 jobs, a social audit will confirm the programme's success. But if the programme has cost N 1,500,000, trained only 90 people, and placed only 10 of them in jobs, the audit will reveal the programme's failure. Such failure should prompt the rethinking of the programme's implementation and its priorities.

3.1.2.4 Problems of Implementing Social Responsibility in Nigeria

Lack of Adequate Funds: A large number of organisations in Nigeria today do not show interest in social responsibility due to lack of funds resulting from low profits. Profits are consistently adversely affected by increased production cost.

Low Disposable Income: The government places heavy tax on large firms which are doing well, leaving them with very little disposable revenue. Hence, social responsibility is never considered a priority.

Political Instability: The problem of political instability scares investors. For those who have already invested, they tend to want to get more of the business profit than investing in the well-being of the society.

3.1.2.5 Corporate Social Responsibility and Reputation Risk

Managers generate reputation gains that improve a company's opportunities to attract resources, enhance its performance and build competitive advantage. Reputation determines how stakeholders are likely to behave towards an organisation. It can influence investors' decisions to hold their shares, consumers' and suppliers' willingness to buy from or sell to it, the extent and nature of media and pressure group attention, potential recruits' eagerness to join it and existing employees' motivation to stay.

Therefore, the interaction between company and stakeholders can increase or reduce its reputation capital and therefore affect the risk of threats and the opportunity platform.

Risk to reputation can arise from the following:

- **Financial performance:** The financial results indicate whether the company strategy is competitive and investors are confident that their investment will continue to reap returns.

- **Corporate governance and quality management**: Displaying good corporate governance is a major contributor to reputation and to market valuation. And this is a reflection of the quality of the leadership.

- **Social, ethical and environmental performances**: Companies should pursue socially-oriented aims, ranging from the protection of the environment as well as the workers' rights, in order to make the economical rule fit the social one.

- **Employees and culture:** Shareholders in an organisation's human capital is leading them to demand information on the kind of people employed in the organisation, their diversity, their skills, their training programmes, their motivation and attitude to their employees, their remuneration, etc.

- **Marketing, innovation and customer relations**: By new processes and innovative goods the company can maintain competitive advantage and by customer satisfaction and good faith in all agreements they have the opportunity to maintain it.

- **Regulatory compliance and litigation**: Not complying with relevant laws and regulations is one of the main risks for both small and large companies: the violation of the laws or internal corporate regulations can imply serious losses as well as bad consequences for company image.

- **Communications and crisis management**: profit as some companies are introducing early warning systems to identify and manage events which may lead to crises, so corrective policies, and pertinent communication actions can be taken before reputation is damaged.

3.1.2.6 Corporate Social Responsibility and Sustainability Report

Recent years have witnessed a remarkable resurgence of academic, professional and corporate interest in the area of social and ethical accounting, auditing and reporting (SEAAR). One striking common feature of the myriad of initiatives taking place lies in an apparent concern to address the information needs of organisational stakeholders via the promotion of dialogue and engagement.

Against the background of critique on the negative social and environmental implications of globalisation, multinational enterprises have become active in reporting on activities undertaken to prevent these externalities of international trade and production.

The sustained nature of sustainability reporting is accompanied by regulatory requirements and government encouragements. The number of reports that includes social (and sometimes also financial) issues has increased considerably. The more traditional topics, on the environment, corporate philanthropy and employees, are now receiving much more attention than the broader external societal issues.

Three phases can be identified in the development of "CSR reporting". The first, dating from the early 1970s, was seen to be composed of advertisements and annual reports that focused on environmental issues but were not linked to corporate performance.

The second phase, in the late 1980s, was characterised by the introduction of social audits, which examined the performance of companies in the areas of social responsibility with respect to communities, employees, customers, suppliers and investors. The third phase, dating from the late 1990s, saw the strengthening of social auditing through the introduction of externally set and verified standards.

3.2 Governance and Stakeholder Theory

Can stakeholder theory play a role in corporate governance? In the agency theory view of the firm, governance is about aligning managerial incentives and providing monitoring of management behaviour. In the stakeholder view of the firm, how can management be forced to internalise the welfare of stakeholders?

Managerial incentives can be provided by rewarding management on the basis of some measure of the welfare of the stakeholders. This process requires clear objectives and performance measurements. Defining

acceptable, multiple missions suitable to all stakeholder groups can be tricky. Another key problem to be overcome is whether a measure of stakeholder welfare is available. It is harder to measure the firm's performance to its employees, customers, etc., than to stockholders. There is no accounting measure (like earnings) or market value measure (like stock price) of the impact of past and current managerial decisions on stakeholder welfare. The result is that aligning managerial incentives with multiple stakeholder groups and measuring overall performance can become a noisy and chaotic process.

To date, there is no consensus on how to measure and report on changes in stakeholder welfare. Ideas that have supporters are the Balanced Scorecard approach and the "triple bottom line. The Balanced Scorecard measures performance in four perspectives: customer, internal processes, employee learning and growth, and financial success. Triple bottom line accounting expands the traditional company-reporting framework to take into account financial, environmental, and social outcomes. While both systems are used by some companies, neither has been generally adopted.

Regardless of the overall measurement of outcomes, organisational theory states that the firm will only value CSR goals if the company executive exhibits strong leadership in instilling corporate responsibility within the company's culture. The values of the culture influence the processes by which the company will try to solve a problem. Executives signal which values are important through both employee incentives and through organisational structure.

The primary means is that of setting the criteria for recruitment and promotion. CSR goals are best executed when individual employees have promotion criteria incentives tied to those goals. A secondary means are the design of organisational structure and procedures that are aligned with the values. Mission statements, which reflect CSR goals and organisational units tasked with interacting with stakeholders, are examples of structural means of promoting culture values. The values set at the top of the company filter down throughout the organisation. Therefore, leadership in corporate responsibility is critical to its adoption by a firm.

3.2.1 Criticisms of Shareholder Theory

The researchers and practitioners of the stakeholder view of the firm use the concepts in different ways and often use contradictory evidence and arguments to support the theory. For example, some characterise stakeholder theory as a descriptive theory. It is used to describe what firms are doing and how they are doing it. Others use stakeholder theory

from an instrumental perspective. This approach provides principles and practices that should be implemented to achieve (or avoid) certain results. They portent that if corporate performance results A, B, and C are desired, then the firm' should implement standards and practices X, Y, and Z. Lastly, the stakeholder view is .used to advocate how firms should behave based on ethical and philosophical principles. Advocates of corporate social responsibility or corporate citizenship use this normative approach.

Is the stakeholder view correct? Should we view firms from a stakeholder perspective? If so, then how can we operationalise it? Because the stakeholder view is not a well-defined theory, it is difficult to assess. As an example, consider one of the primary stakeholders, employees. Providing employees with high quality health care seems consistent with the tenets of the stakeholder view of the firm. The descriptive approach might ask how many companies are providing quality health care. The instrumental approach would be interested in how the providing of quality health care impacts the firm's stock returns and operating performance. The normative approach advocates that firms should provide quality health care because it is the moral thing to do. However, none of these provide the chance to accept or reject the validity of the stakeholder view.

Since the stakeholder view of the firm is difficult to empirically validate or reject, can it be philosophically criticised? Even critics of corporate citizenship agree that companies should act responsibly and should be seen doing so. After all, this is often good for business. However, that is different than aggressively pursuing the corporate social responsibility doctrine advocated today. Indeed, critics argue that deviating too far from the profit-maximising role of companies would be harmful to society.

The critics' argument stems from the experience that economic progress comes from profit-related activities. The primary role of business in society is to act as a vehicle for economic development. In a market-oriented economic system, economic progress results from entrepreneurial opportunities and competitive pressures. Successfully introduced new or improved products enhance profits while increasing the quality of life in society. Competition forces business to continually work to provide goods and services more effectively and more efficiently.

When managers have to take into account a wider range of goals and involve themselves in stakeholder engagement activities, higher costs and impaired business performance is likely to follow. When trying to serve "many masters," managers often become ineffective in achieving

any of the goals. Indeed, more exacting environmental and social standards will bring more regulation. Overregulation exacts an enormous cost on society in the form of limiting competition, narrowing opportunities, and worsening economic performance. History shows that when the economy is intentionally focused on social goals, such as employment, production, etc., society becomes worse off. The poor economic performance of the former Soviet Union, Cuba, and China (before its more recent move toward a market-based economy) shows this.

3.3 International Perspectives

Corporate citizenship has different historical roots in different regions of the world and therefore is viewed with different perspectives. For example, CSR in the U.S. derived from the conflict between stockholder-focused managers and social activists. This unenthusiastic relationship between companies and some activist groups created a negative attitude towards stakeholder theory in the business community. Over the past few decades, many U.S. business groups have slowly began to embrace CSR ideas. In the UK and Europe, corporate citizenship has been viewed less negatively and is currently a more holistic concept. In India, the lack of government efficacy in the provision of social welfare has caused corporations to step into the role of helping society. Stakeholder concern is integrated within the firm and is based on family values.

A stakeholder view of the firm is also reflected in many laws internationally. In the U.K., company directors are mandated to include the interests of employees in decision making (Companies Act). In Germany, employee representation is required on one of the two-tier boards (co-determination laws). The European Union permits corporations to take into account the interests of employees, creditors, customers, and potential investors (harmonisation laws). In Japan, after the World War II, corporations were tasked with the responsibility for rebuilding the Japanese economy. The same was true for Korea after its Korean War in the 1950s. Korean companies that focused on exporting were even given tax breaks to help them bring capital into Korea.

SELF ASSESSMENT EXERCISE

1. Do you think corporations should have a responsibility to society in general? Explain.
2. Let’s say companies should be good citizens. How can this be measured? How can it be enforced?

4.0 CONCLUSION

The stakeholder view of the firm does not focus on the maximisation of shareholder wealth but rather an optimisation of the sustainable economic wealth of all stakeholders. Stockholders, employees, customers, communities, and the environment are just some examples of stakeholders. Their legitimate interest in the firm arises from the perspective that these stakeholders have property rights in the firm. Corporate stakeholder relationships have different historical roots in different regions of the world and therefore are viewed with different perspectives.

5.0 SUMMARY

The modern evolution of the stakeholder view of the firm, called corporate social responsibility or corporate citizenship, advocates that companies have a social obligation to operate in ethically, socially, and environmentally responsible ways. By embracing citizenship goals, corporations may insulate themselves from activist actions, enhance the firm's reputation, and find that their goodwill opens doors to new communities and additional sales. Therefore, a sense of corporate citizenship potentially represents another way to affect business people's behaviours and actions. In this sense, it can be considered a monitor. But is the corporate social responsibility concept good for society? It is difficult to do well while doing good. A company can fail in its social goals and still succeed as a business but it cannot fail as a business and still succeed in its social goals. In addition, how do we create a governance system based on this sense of citizenship?

6.0 TUTOR-MARKED ASSIGNMENT

1. Does your country subscribe to an agency view or the stakeholder view of the firm? Explain.
2. What is your overall opinion of the role of your country's firms in your country? Is it good for the long run? What criteria (profits, environment, etc.) should be applied?

7.0 REFERENCES/FURTHER READING

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